A TREATISE

ON

INDIAN INCOME-TAX LAW & ACCOUNTS

ABRIDGED EDITION FOR STUDENTS

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MEANING OF INCOME

Income-tax, as indicated by the term itself, is a tax on income as distinct from capital. In many instances, it is particularly difficult to distinguish between Income and Capital. The line of demarcation is often very faint. A clear grasp of the distinction depends on a study of the case laws and principles of accountancy. The following cases* will illustrate the point :—

(1) X transfers a portion of his estate to Y and in return accepts an annuity for life and a lump sum. Does this annuity represent income or capital? (Maharaj Kumar Gopal Saran's case, 1935, I T R 237).

(2) X's income is charged by a court decree which he has to pay monthly as maintenance allowance to his mother. Is this amount income of X? (Raja Bijoy Singh Dudhuria *vs.* C I T, Bengal., 1933, 1 T.R. 135).

(3) X was a distributing agent of Y. Y terminated the agency and paid a compensation. Is this sum paid to X Income? (Shaw Wallace's case, 1932, 6 I.T.C. 178).

(4) X is an agent of Y for a number of years. Y terminates the agency and pays X a compensation. Is this sum paid to X income?

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* These cases have been fully discussed elsewhere in the book. References will be found in the last page.

(Anglo-Persian Oil Company, Ltd., *vs.* C.I.T., Bengal, 1933, I.T.R. 129).

(5) X and Y are rivals in a trade. They enter into an agreement for a particular number of years. Later on Y terminates the agreement and pays X a compensation. Is this compensation income or capital? (Van Den Bergh's case, 1935, I.T.R. 17).

(6) X leased out his house to Y. Subsequently there was a breach of the conditions of the lease. It ended in a compromise by payment of Rs 1,00,000. Is this amount income or capital? (Gooptu Estates, Ltd., 1930, 4 I.T.C. 146).

(7) A "Recovery Fund" is created out of contributions to the company from its borrowers to cover the losses from non recovery of loans. Is this fund income or capital?

(8) X who is a resident but not ordinarily resident has sterling securities in U.K. Interest on securities accrues, but before bringing the income into British India he purchases a machinery in U.K. with the money and then brings the machinery into India. Does this represent income or capital? (Ahmedabad Advance Cotton Mill's case 1938, I.T.R. 31)

(9) A Company makes a profit and the Company distributes the profits in the form of Debentures. In the hands of the shareholders, are the profits so distributed income or capital? (C.I.T., Bengal, *vs* Mercantile Bank of India 1936, I.T.R. 237).

(10) A sells his copyright or patent and gets a lump sum or a periodical payment of royalty. Is

this receipt income or capital? (Inland Revenue Commissioners *vs.* British Salmson Aero Engines, Ltd., 1939, I.T.R. 245) and (Ministers of National Revenue, Canada, *vs.* Catherine Spooner 147 I.C., 747 P.C. 1933 I.T.R. 299).

(11) A sends an essay in a competition and gets a reward of Rs. 5,000. Is this income or capital?

(12) A who by profession is a doctor gives friendly help to a Company to sell shares to the public. The Company out of gratitude makes a payment of Rs. 3,000 to A. Is this income or capital?

(13) A who does not belong to the Police Department traces an absconder and gets a reward of Rs. 5,000. Is this income or capital?

(14) A Government servant retires. By commuting his pension he gets Rs. 20,000. Is this income or capital?

Income, for the purposes of a business and its owner, is ascertained by Profit and Loss Account but that is not necessarily the income for income-tax purposes. From the point of view of income tax, income is determined by the statutes of the Income-tax Act.

In the case C.I.T. Bengal *vs.* Shaw Wallace (1932, 59 I.A. 206), Sir George Lowndes observed "The object is to tax income, a term which it does not define. It is expanded, no doubt, into 'income, profits and gains' but the expansion is more a matter of words than substance." In the same judgment, income has been stated to mean "a periodical monetary return coming in with some sort of regularity from definite sources." Such decisions of eminent judges and judicial pronouncements

and observations render the utmost assistance but the Act lacks a statutory definition. It does not seem possible to define in view of the very faint line of demarcation between income and capital.

The words "profits and gains" however can be more successfully differentiated from the word "income," the former being the result of the incomings and outgoings of trade, business, etc., and the latter referring broadly to the incomings only. In spite of these subtle differences of usage in the meanings, the word income in the term Income tax includes profits and gains. Between the words "profits and gairs", however, there does rot exist any difference except the conventions which have grown up in connection with these expressions.

In fact, the entire Act is an attempt to define Income, Profits and Gains. To be more accurate, the Act does not define but lays down the conditions and circumstances in which assessability arises or otherwise.

Section 1.—(1) This Act may be called the Indian Income-tax Act, 1922.

(2) It extends to the whole of British India, including British Baluchistan and the Senthal Parganas, and applies also, within the Indian States and the tribal areas, to British subjects who are in the service of the Crown or of a local authority established in the exercise of the powers of the Crown Representative or the Central Government in that behalf, and to all other servants of the Crown in the said States and areas.

(3) It shall come into force on the first day of April, 1922.

NOTE.—The General Clauses Act defines British India as "All territories and places within Her Majesty's dominions which are, for the time being governed by Her Majesty through the Governor-General of India or through any Governor or other officer subordinate to the Governor-General of India."

(1) Native States, (2) lands ceded by Native States to British Government for particular purposes but on which their own rights are retained (*e.g.*, for railway stations, cantonments, etc.) are not British India.

British Nationality and Status of Aliens Act provides that a British subject is "a person who is a natural born British subject, or a person to whom a certificate of naturalisation has been granted or a person who has become a subject of His Majesty by reason of any annexation of territory."

JURISDICTION :

The Act extends to :—

(1) British India including British Baluchistan and the Sonthal Parganas, and tribal areas,

(2) Native States to the limited extent, *viz.*, to British subjects, in the Native States, who are the employees of

(a) The Crown, or

(b) A local authority in British India established in the exercise of the powers of the Crown Representative, or

(c) The Central Government,

(3) Native States to the limited extent, *viz.*, to all other servants of the crown (British subject or non-British subject).

Section 2.—In this Act, unless there is anything repugnant in the subject or context,—

(1) "agricultural income" means—

(a) any rent or revenue derived from land which is used for agricultural purposes, and is either assessed to land-revenue in British India or subject to a local rate assessed and collected by officers of the Crown as such;

(b) any income derived from such land by—

(i) agriculture, or

(ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market, or

(iii) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in sub-clause (ii);

(c) any income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator, or the receiver of rent-in-kind, of any land with respect to which, or the produce of which, any operation mentioned in sub-clauses (ii) and (iii) of clause (b) is carried on:

Provided that the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent or revenue or the cultivator or the receiver of the rent-in-kind by reason of his connection with the land, requires as a dwelling-house, or as a store-house, or other out-building;

NOTE.—(1) Rent is defined as "whatever is lawfully payable or deliverable in money or kind by a tenant to his landlord on account of the use or occupation of the land held by the tenant" (Bengal Tenancy Act.)

(2) Rent means "whatever is, in cash or kind or partly in cash and partly in kind, payable on account of the use or occupation of land or on account of any right in land . . ." (U.P. Tenancy Act of 1939.)

(3) Rent has been defined to mean "Money, share of the crops, service or any other thing of value to be rendered periodically or on specified occasions by the tenant to

the landlord in consideration of the enjoyment of immovable property." (Transfer of Property Act.)

(4) There is no definition of 'Agriculture' in the Act. The term should be interpreted in the light of observations and judgments of the various decided cases.

(5) Agricultural income which is exempt from the tax means :—

(a) Rent or Revenue derived from land,

(b) Income derived from agriculture,

(c) Income derived from the performance of the processes ordinarily employed to render the produce marketable.

(d) Sale by cultivator of the produce in respect of which no process has been performed other than a process in (c) above,

(e) From any building required for agricultural purposes.

(6) Rent or Revenue derived from land :—

The addition of the word 'revenue' to the expression 'rent' clearly indicates that the scope contemplated is much larger than the narrow definition of rent as given in the Tenancy Acts and Transfer of Property Act.

(7) Agriculture has been stated by Justice Bhashyam Aiyangar to mean

"Cultivation of the ground for the purpose of procuring vegetables and fruits for the use of man and beast including gardening or horticulture and the raising or feeding of cattle and other stock

Agriculture has been stated by Justice Sadasiva Ayyar to mean—

"the raising of annual or periodical grain crops through the operation of ploughing, sowing, etc."

Agriculture has been stated by Justice Spencer to mean—

"the raising of useful or valuable products which derive nutriment from the soil with the aid of human skill and labour and thus it will include horticulture, arboriculture and sylviculture in all cases where the growth of trees is effected by the expenditure of human care and attention in such operation as those of ploughing, sowing, planting, pruning, manuring, watering, protecting, etc."

Accepting the above, Agriculture includes vegetables, sugarcane, fruits, cereals, paddy, flower, indigo, tea, cotton, jute, flax tobacco, etc. It will, under certain circumstances include rearing of livestock also.

RULE 23 (1) In the case of income which is partially agricultural income as defined in Section 2 and partially income chargeable to income-tax under the head 'Business' in determining that part which is chargeable to income-tax, the market value of any agricultural produce which has been raised by the assessee or received by him as rent in kind and which has been utilized as raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted and no further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent in kind.

(2) For the purposes of sub-rule (1) "market value" shall be deemed to be—

(a) where agricultural produce is originally sold in the market in its raw state, or after application to it of any process ordinarily employed by a cultivator or receiver of rent in-kind to render it fit to be taken to market, the value calculated according to the average price at which it has been so sold during the year previous to that in which the assessment is made,

(*b*) where agricultural produce is not ordinarily sold in the market in its raw state, the aggregate of—

(1) the expenses of cultivation;

(2) the land revenue or rent paid for the area in which it was grown; and

(3) such amount as the Income tax Officer finds, having regard to all the circumstances in each case, to represent a reasonable rate of profit on the sale of the produce in question as agricultural produce.

Profit and Loss Account

Illustration 1	Rs.		Rs.
To Stock of Sugar	2,000	By Sugar Sales	18,000
,, Manufacturing Charges	1,700	,, Molasses Sales	3,000
,, Sugarcane Purchase	8,000	,, Stock of Sugar and Molasses	2,000
,, Lime	100		
,, Sulphur	55		
,, Coal	400		
,, Bags	100		
,, Laboratory Stores	200		
,, Lubricants	25		
,, Salaries and Wages	2,500		
,, Cane Growing Cost*	70		
,, General Charges	280		
,, Net Profit	7,570		
	23,000		23,000

*The cost of cane growing is Rs. 70 for 1,100 maunds of sugarcane. According to rule 23(1), the company is entitled to deduct the market value of the sugarcane produced and used for manufacture; the market value is taken to be Rs. 350.

P and L Adjustment Account

	Rs.		Rs.
To Market Value of cane sugar grown by the company and crushed for manufacture	350	By Net profit	7,570
,, Assessable profit	7,290	,, Cane growing cost	70
	7,640		7,640

QUARRY— Where a land assessed to land revenue is worked as quarry, the profits derived from quarries are not agricultural income, hence taxable (Shib Lal Gangaram, 1927, 2, I T C 425)

FISHERY—Profits are not agricultural income. (Prabhat Chandra Barua *vs* Emperor, 1930, 57, I A., 228; Rajendra Narain Bhanja Deo *vs* C I T , Bihar, 1937, I T.R 111.)

PASTURAGE—Receipts are agricultural income (Probhat Chandra Barua *vs* Emperor)

MARKET— Profits from Markets moorings or ferries are not agricultural income (Maharaja of Darbhanga *vs*. C I.T., Bihar 1924, 1, I.T C 303; Rajendra Narain Bhanja Deo *vs* C I T , Bihar, 1937, I.T R 111.)

SALT FROM SEA WATER—Income from it is not agricultural income (C I T Madras *vs* Linga Reddi 1927, 2, I.T.C. 368.)

PRIVATE CANALS— Whether income is in cash or in kind by sale of this water, the income is taxable (Sir Umar Hyat Khan *vs*. C.I T., Punjab, 2, I T.C. 52.)

ROYALTY—Received for granting permission to take out kankar is taxable. (Maharani Janki Kunwar *vs*. C.I.T., Bihar, 5, I.T.C. 42.)

INTEREST ON CASH LOANS—Repayable in paddy is not agricultural income. (Haji Cassim Tayub Soorty *vs.* C.I.T., Burma, 1932 A.I.R. 19.)

INCOME FROM COTTON—Ginning profits from cotton marketed after ginning in a ginning factory are taxable, ginning not being essential to render cotton to be "fit to be taken to market." (Sheo Lal Ram Lal *vs.* C.I.T., C.P., 4, I.T.C. 375.)

COTTON, SILK, JUTE AND RUBBER—are agricultural incomes but where they are considered on the border line it will be a question of fact as to how much should be taxed.

GUR AND BROWN SUGAR MAKING—are agricultural income.

TODDY—Income derived from toddy is agricultural income to the person who has produced the trees from which toddy is tapped

MILLING OF PADDY—is not agricultural income.

COAL, MICA, ETC.—Profits are not agricultural income.

LAND UNDER LEASE—The land need not be cultivated by the owner himself. Income from leased land would be income from agriculture both to the lessor and the lessee and to all the intermediary tenure-holders.

DAIRY—There are many incomes which are on the border line between agricultural and non-agricultural incomes. Dairy income is an instance to the point. They are not agricultural incomes if they are in the urban areas where the cattle are wholly stall-fed but if they are in rural areas where the cattle are pastured upon, the sale of milk is agricultural income and exempt from the tax. (Kokine Dairy Firm, Rangoon, 1938, I.T.R. 145.)

POULTRY—Income from poultry farming is also to be judged in the same way. Poultry farming comes under husbandry and husbandry presupposes a connection with land and raising of crops. Where the dairy or poultry is not carried on by individual farmers but by an organisation of a training business unconnected with occupation of land, the income should not legitimately come under "agricultural income."

FLOWER GARDEN—The owner has a shop in Calcutta flower market. His profits are not taxable.

ROYALTY received for granting permission to manufacture bricks is not agricultural income

MANGO GARDEN—The owner sells it out on yearly lease. Profits are not taxable

LAC—Growers' profits from sale of lac are not taxable but when lac is converted into other products they are taxable.

FOREST INCOME—It is agricultural income. (Secretary of State *vs.* *Zamindar* of Singampatti 1922, 1, I.T.C. 181.)

"If a landowner grows on his own land which is assessed to land revenue forests or trees and derives income therefrom he is not liable to income-tax on such income. Persons, however, who take contracts in forests for the cutting down and selling of timber are liable to tax." (I.T.M.)

SUGAR INDUSTRY—

(*a*) Sugar-refining is not agricultural income.

(*b*) In the matter of Bhikanpur Sugar Concern (Bihar, 1919, 1, I.T.C. 29), the Company used to grow sugar cane crop on its own land and also manufactured sugar in an up-to-date factory—the agricultural and manufacturing sections being independent of each other.

The Patna High Court held that the Company was not a cultivator and the income was not agricultural income within the meaning of section 2(1) (b) (ii) of the Act. This case was decided in 1919 on the basis of the Income-Tax Act of 1918. Subsequent to this, in Killing Valley Tea Co.'s case the Calcutta High Court for the first time indicated a taxable and non-taxable percentage.

TEA INDUSTRY—

While the planting of tea bush and collection of leaves is agricultural income, the manufacturing of tea as a marketable commodity from leaves is taxable.

In Killing Valley Tea Co., Ltd., *vs.* Secretary of State (1921, 1, I T C. 54), it was decided by the Calcutta High Court that when tea is grown and manufactured in British India a portion of the profits and gains derived from its sale in British India must be regarded as "agricultural income" Sir Ashutosh Mukherjee, Ag. C.J., observed "Bearing all these principles in mind, we hold that the Company must be taxed to the limited extent indicated because they come within the letter of the law to that extent. As the contentions of both sides have succeeded only in part we make no order as to costs . . "

Tea Companies ordinarily hold their lands under tea grant leases, not under common cultivating leases and are assessed to road cess not as ordinary cultivator but under the special provision found in section 33 of the Cess Act of 1880. Government, as a matter of fact, refrained until 1919 from assessing the profits of tea gardens to income-tax. It seems that in 1919 the Government already notified that tea gardens could be taxed: immediately after this, came the decision of the Calcutta High Court quoted above As a result of the observations of the Calcutta High Court, the Government fixed a percentage (now 40 per cent.) of the income on which tax is imposed.

INDIAN TEA CONTROL ACT :—

Under section 15 of the Indian Tea Control Act, 1933, the owner of a tea estate may transfer his right to obtain export licences in whole or in part to any party. The profits resulting from the sales of such export and production quotas and, on the other hand, the expenditure incurred by the transferee in purchasing such quotas should be treated as follows for the purpose of the assessment of income-tax with reference to Rule 24 of the Indian Income-tax Rules, 1922 Where the quotas are transferred by the owner of a tea estate to which they appertain, the price realised should be treated as if it were income derived from the sale of tea grown and manufactured by the seller, since the allocation of the quota has resulted from the growth and sale of tea by the seller in previous years In that case, therefore, only 40 per cent of the income derived from the sale of the rights will be held liable to tax. Where, however, a further transfer is made by a person other than the owner of the tea estate to which the quota has been so allotted, whether or not such person is himself the owner of a tea estate to which another quota has been allotted, his profits on that transaction cannot in any sense be said to have resulted from the growth by him of tea and will have to be treated as wholly taxable in the assessment of the seller The same applies to the profits made by an owner of a tea estate out of a transaction in which he buys a quota and uses it for the export of tea grown in an estate not his own (e g , after manufacturing tea in his factory from green tea grown elsewhere) If a quota is purchased by the owner of another tea estate and is utilized by him for the exportation of tea grown on his own estate, such purchase enables the purchaser to market the product of his own tea estate, and it follows that the cost of buying the quota will have to be debited to the income of the concern before apportionment under Rule 24 of the Indian Income-tax Rules. Where the quota is purchased by a person who is not the owner of a tea estate, or if purchased by the owner of a tea estate is resold by him, or is used by him for the export of a tea grown on an estate not his own, the expenditure will be allowed in full in computing the purchaser's profits, since, as already explained, the net profits of such a person from the transaction are taxable in full and are not covered by Rule 24 of the Indian Income-tax Rules. (I.T.M.)

Illustration 2.

NORTH JALPAIGURI TEA COMPANY, LTD.

Revenue and Profit and Loss Account for the year ended . . . . .

	Rs.			Rs.
To Garden Expenses:—		By proceeds of the crop		
,, European establishment ...	60,000	Assam	2,90,000	
,, Indian establishment	80,000	Doors	3,05,300	
,, Cultivation ..	1,10,000			5,95,300
,, Coolie recruiting	7,000	,, Tea seed (5)		1,200
,, Coolie expenses	5,000	,, Profit on sale of investments		1,050
,, Stores and Tools	2,000	,, Miscellaneous receipt being		
,, New buildings including replacements (1)	12,000	Sale of sweepings	1,500	
,, New machinery including replacements (2)	15,000	Post Office rent (10)	500	
,, Repairs to buildings (3)	1,500	Shop rent (11)	300	
,, Repairs to machinery	1,200	Rent of paddy lands (8)	700	
,, Medical expenses	2,400	Sale of scrap metal (9)	500	
,, Crop expenses	4,600			3,500
,, Manufacturing and packing	2,300			
,, Tea boxes	3,500			
,, Freight and charges on tea	7,500			
,, Govt rent and cess	2,200			
,, General charges	3,800			
,, Insurance (hail)	250			
,, Tea seed crop (4)	700			
,, Surveying (6)	300			
,, Purchase of export licences and production rights (7)	1,800			
,, General Expenses:—				
,, Charges general including rent, salaries, etc	70,000			
,, Commission to managers and staff	8,000			
,, Net profit	2,00,000			
	6,01,050			6,01,050

Revenue and Profit and Loss Adjustment Account.

		Rs.			Rs.
To Tea seed	1,200		By N. P.		2,00,000
Less Tea seed Crop	700		New Buildings		4,000
	—	500	,, Extension to godown included under repairs to buildings		1,000
To Profit on sale of investments		1,050	By New machinery	2,000	
To Provident Fund		14,000	Less cost of old sifters replaced	250	
To Rent of Paddy lands		700		—	1,750
,, Sale of scrap metal		600	By Surveying		300
,, Income fully assessable					
Post Office rent	500				
Shop rent	300				
	—	800			
To Adjusted Profit		1,89,500			
		2,07,060			2,07,050

40% of Rs 1,89,500		Rs 75,800	0	0
Add income fully assessable	...	Rs 800	0	0
	Total Income	Rs 76,600	0	0

NOTE —(1) New Building expenditures have amounted to Rs 4,000 and replacements Rs 8,000.

(2) New machinery expenditures have amounted to Rs 2,000 and replacements Rs 13,000.

(3) Repairs to Buildings include an item of expenditure, *viz*, extension to godown amounting to Rs 1,000.

(4) & (5) Tea seed crop is an expenditure on Tea seeds produced proceeds being Rs 1,200 in the Account above. Both these relate to agricultural income and have been eliminated from the account

(6) Surveying has been found to be a Capital item and hence disallowed

(7) The question of purchase of production rights is a little complicated. If the purchaser of the production rights sells out a portion to another Tea manufacturer,

the entire profits thus accrued would be taxable. If the purchaser utilises the rights fully for himself then the profits will be normally shown in the accounts and 40 per cent. will automatically be taxed.

(8) Rent of paddy land is agricultural income and not taxable.

(9) Sale of scrap metal is a Capital item and therefore not taxable.

(10) & (11) Post Office rent and shop rent are fully taxable as they have nothing to do with tea business

(12) Provident fund allowable as a deduction was not debited in the account; hence debited now.

SIMPLE MORTGAGE- Interest received by a simple mortgagee of agricultural land is not agricultural income - hence taxable.

USUFRUCTUARY MORTGAGE- Transfer of Property Act defines it as follows: " Where the mortgagor delivers possession or expressly or by implication binds himself to deliver possession of the mortgaged property to the mortgagee and authorises him to retain such possession until payment of the mortgage money and to receive the rents and profits accruing from the property or any part of such rents and profits and to appropriate the same in lieu of interest or in payment of mortgage money or partly in lieu of interest or partly in lieu of mortgage money, the transaction is called usufructuary mortgage "

(1) In case of pure usufructuary mortgage the money received by the mortgagee is agricultural income.

(2) In the case where the assessee carried on money-lending business and took usufructuary mortgage of lands and then immediately leased back to the mortgagor stipulating some fixed annual payments these annual payments were decided to be agricultural income (Mukand Sarup *vs.* C.I.T., U.P., 1928, 2, I.T.C. 495).

(3) A person executed in favour of the assessee a usufructuary mortgage for securing the capital sum of the loan and interest thereupon. Likewise, the assessee also executed lease of the properties covered by the mortgage bond in favour of the mortgagor. The question was as to whether the income derived by the assessee was agricultural income and it was decided that the nature of the transaction was not of usufructuary mortgage but that of a simple mortgage. The interest reserved by the documents and paid to the assessee during such period as he was not in possession of the leased property was not agricultural income. Whether a mortgage is usufructuary or not will depend upon the deed. (Rajniti Prasad Singh *vs* C.I.T., Bihar, 1930, 4, I.T.C. 264)

(4) Assessee carrying on money lending business makes an income of rent which he obtained from property under mortgage (usufructuary) and which he appropriated towards interest. It was decided that the rent was agricultural income though it was appropriated towards interest and hence not assessable. (Hajee Mohammad Sadak Khoyee *vs*. C.I.T., Madras, 1935, I.T.R. 1).

(5) Assessee carrying on money lending business makes an income of rent from property taken on usufructuary mortgage. The Patna High Court decided that the amount in question was agricultural income. On appeal to the Privy Council by the Commissioner, Privy Council confirmed the decision of the High Court. The question is thus set at rest. Lord Macmillan observed "The result, in their Lordship's opinion, is to exclude agricultural income altogether from the scope of the Act, however or by whomsoever it may be received." (C.I.T., Bihar *vs*. Sir Kameshwar Singh, 1935, I.T.R. 305).

From the Madras decisions, it became necessary to see as to who received the rent from the tenants. If the mortgagee collects it, it is agricultural income in his hands

and it is exempt from the tax. The Judicial Committee in the above case (5) observes, "as Ashworth, J., puts it in Makund Sarup *vs.* Commissioner of Income Tax, United Provinces—" The business of money-lending may bring in an income which is exempt from income-tax on the ground that it is derived from agricultural land. The exemption is conferred, and conferred indelibly on a particular kind of income and does not depend on the character of the recipient. . . . . ."

This view is also held in the observation in the case of S. L. Mathias where the following occurs " The mere circumstance that income from agriculture has to be placed under the head ' Business' has no effect to negative its being agricultural income as defined by the Act."

When does Agricultural Income Arise?

(1) In Mohanpura Tea Co.'s case (1937, I.T.R., 118, Bengal), the Calcutta High Court held that in the case of tea grown in a native state and sold in British India, the entire income is deemed to have arisen in British India and hence assessable. The Calcutta High Court observed in a previous case (Port Said Salt Association, Ltd., 6 I.T.C., 123, Bengal) that " profit is not realised before price and when the article is sold the whole profit is realised for the first time and it accrues where it is thus realised." Basing on this interpretation of " accrual ", the judges in the Mohanpura Tea Co.'s case decided that the income accrued in British India and therefore section 4(1) applied and that section 4(2) could not be applied and also decided that as section 4(2) could not be applied, the second proviso could not come into operation. Therefore income is deemed to have arisen where sale takes place notwithstanding that tea is manufactured elsewhere.

(2) In Mathias *vs.* C.I.T., Madras, 1937, I.T.R., 435, the assessee owns coffee plantations in Mysore, and is

a resident of British India (Mangalore), and has offices in Mysore and in Mangalore. Produce was brought to Mangalore in raw state, and was sold in Mangalore. The Income-tax Commissioner decided that the income accrued in British India and therefore not exempt. The Madras High Court decided that the assessee was entitled to claim the benefit of the second proviso to section 4(2) and therefore exempted.

Comparison of the two cases.

Calcutta High Court (Mohanpura)	Madras High Court (Mathias)
(1) Tea grown in Native State	(1) Coffee grown in Native State
(2) Tea sold in British India	(2) Coffee sold in British India
Hence produce arises in Native State and income arises in British India (when sold)	Hence produce is received in kind in Native State
Hence (a) section 4(1) applies	Hence income arises in Native State.
(b) Section 4(2) second proviso does not apply (because income has not arisen in Native State).	Hence section 4(2) second proviso does apply*
Therefore *Income not exempt*	Therefore *Income exempt.*

In the above case of S. L. Mathias, the Commissioner of Income-tax, Madras, appealed to the Privy Council against the decision of the High Court.

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* The 2nd proviso of sec. 4(2) has been deleted by the Amendment Act of 1939 —

Section 4(2) provides, "Income, profits and gains accruing or arising without Br. India to a person resident in Br. India shall, if they are received in or brought into Br. India, be deemed to have accrued or arisen in Br. India and to be income, profits and gains of the year in which they are so received or brought notwithstanding the fact they did not so accrue or arise in that year."

2nd Proviso:—"Provided further that nothing in this subsection shall apply to income from agriculture arising or accruing in a State in India from land for which any annual payment in money or in kind is made to the state."

It was observed in the judgment "But it appears to their Lordships that other considerations decide this appeal and that it is *unnecessary* to determine whether the income in question accrued or arose within or without Br. India."

Thus it was thought unnecessary (as stated in the judgment above) because, the judgment continues " The contention of the income-tax authority has been throughout that the income assessed to tax was not within section 4(2) because it did not accrue or arise outside British India...... It was contended therefore that the assessee was liable under section 4(1) and that sub-section (2) and its proviso did not affect the assessee's liability. The answer given by the High Court has been stated and is now to be examined."

The judgment continued " The answer proper to be given to the question stated by the Commissioner is that no part of the income therein mentioned is exempted from taxation under the second proviso to section 4(2) of the Indian Income-Tax Act."

The Judicial Committee thus gave its judgment in the form in which the Commissioner put the question.

In the case, Raja Probhat Chandra Barua *vs.* King Emperor, 1930, the following questions came up for decision :—

(I) Whether the following incomes were agricultural under the Act :

(1) Jalkar or rent received from fisheries,

(2) Ground rent for land used for potteries,

(3) Ground rent for land used for brick-fields,

(4) Fees received from the tying up of boats,

(5) Fees received from land used for storing purchase of crops.

(6) Fees received from cart stands,

(7) Punyaha nazar or nazar paid by tenants of agricultural holdings at the beginning of Zamindari year,

(8) Nazar for petitions presented to the zamindar dealing with question of succession, settlement and partition,

(9) Ground rent for permanent shops, hats and bazars,

(10) Stall fees paid by temporary sellers at hats and bazars.

(II) Whether income derived from such of the above sources as were not taken into consideration at the time of fixing the Jama at the time of the Permanent Settlement is assessable for income tax purposes

(III) Whether having regard to the terms of the Permanent Settlement Regulation, income derived from the above sources in permanently settled areas is liable to assessment to income-tax.

On the question embodied in the III item, conflict arose and Sanderson C. J. and Rankin J referred the case to full Bench consisting of Mukerjee, Suhrawardy, Ghosh, Buckland, Panton J.J.

The first two judges answered question 3 in the negative, *i.e.*, income derived from the above sources in permanently settled estates is not taxable but the last 3 judges answered in the affirmative.

The case was then before the Privy Council who, however, agreed with the above majority and answered in the affirmative, observing,

"The problem of the correct answer to question 3, has been now considered before different courts in Madras, Patna and Calcutta by 13 Judges. As their lordships read the various decisions,

it would appear that 5 of the 13 Judges would answer question III in the affirmative and 8 would answer in the negative."

"The language used in the Regulation does not mean anything than this: You have in the past been liable to have the amount of the jama increased according as the actual produce of the estates increased; to enable the Government to obtain this, you have been subjected to frequent investigations to ascertain the actual produce and you have been deprived of the management of your estates. All this shall cease. You shall have fixity of payment and fixity of tenure. If you improve the revenue of your Zamindari you shall enjoy the fruits of your improvements without fear of the Government claiming that, because the revenue produced by the estate has increased, the payment you make to the Government as a condition of holding that estate shall be increased also."

"Their Lordships were unable to ascertain upon what footing the appellant had been assessed in respect of the income derived from his zamindari, i. e., whether on the gross income or after some allowance had been made in respect of the jama assessed and paid upon the lands. Their lordships are of opinion that, in assessing the appellant to income tax in respect of the income derived from his zamindari, his income, profits and gains from that source should be computed after making proper allowance in respect of the jama assessed and paid.

"It follows that in their Lordships' opinion, questions 2 and 3 should both be answered in the affirmative. Question 1 was but faintly argued before the Board. As to it, their Lordships need only say that they have not been furnished either with materials or reasons which would justify them in suggesting that any specified item could properly be described as agricultural income within the definition contained in sec. 2(1) of the Income-tax Act 1922. Their Lordships accordingly agree with the negative answer which has been given to question 1".

In the case Emperor *vs.* Probhat Chandra Barua, 1927, I.L.R. 54, Cal., 863, before the Full Bench, Mr. N. N. Sircar, on behalf of the assessee, argued :—

"The first question argued by Sir B. C. Mitter is whether there was a promise of general immunity. I object to the words used. No one argued absolute immunity. What was argued was

that direct demand from land was absolutely given up. In this case it is direct imposition on land.

Next, as regards the scope and true meaning of the word Jama. Some confusion has been made on this matter. Jama was not here rent in the sense of being a share of the produce of land. In the Permanent Settlement Regulation, it was the consolidated amount that was fixed after taking a certain share of the profits from land, fisheries, forests, etc.,—in fact from everything arising out of land and water within the ambit of permanently-settled estates. Certain internal duties levied by the zemindar upon the tenants were excepted. Everything was taken into account in assessing the jama. The zemindar had to file returns on everything. The demand was of all present and future incomes. Resumption of unassessed lands was provided for. My friend's idea is that the jama was only of agricultural lands. That is not so. Fishery also was included. See Maharajadhiraj of Darbhanga vs. Commissioner of Income-tax, I. L. R. 3, Pat. 470, Baden-Powell on "Land Revenue," p. 159. Philips on "Land Tenures," pp. 269, 24 and Colebrooke's Supplement, which gives all details.

Of the Parliamentary Statute, 24 and 25 Geo. III, c. 25, S. 39, in pursuance of which these enquiries were made, it will be quite clear that the intention of the Legislature was to fix the jama in perpetuity. The Regulation will be quite clear when we bear in mind the above. We need not go into ancient history. See also Fifth Report, Firminger's Edition, p. 30, Reg. II of 1819 Preamble and Art. 31, para 2; Reg. I of 1793, Art. 9; Field's Regulations, p. 190.

It was incorrect to say that jama only as regards agricultural land was fixed for ever. That is my friend's reading of the Regulation in view of the Income-tax Act. The truth is, jama or public demand had been fixed for ever. The contention of my friend that so long the jama was not increased, limiting the term to profits of agriculture, the zemindar had no grievance is fallacious.

Leave aside for the present the question of abrogation.

The question is—are you increasing the revenue? Income-tax being also revenue, call it by whatever name you will, there is increase of revenue. I do not claim general immunity.

(Buckland J. Jama does not really mean income.)

Jama no doubt is what is paid to Government. It is, however, "public demand" based on everything including fishery. It is abundantly clear from the statement that the Permanent Settlement was made because the value of the land was not going to be affected by the apprehension of further imposition. Even Rankin J. did not base his decision on the assumption that there was no promise. As to what the effect of the later Acts is, is another matter.

Imposition of Income-tax on fisheries, which had already been charged to revenue, would certainly amount to a breach of the promise contained in the Regulations. Any additional imposition, whether as jama or tax, on the profits of land and water in permanently-settled estates would be illegal.

Mr. Justice Panton has referred to Income-tax charged on the interest paid on G. P. Notes, although there was the promise on the part of the Government to pay interest at the rate of 3½ per cent. or 5 per cent. as the case might be. But a G. P. Note is not a promise by the sovereign as such. There the Government acted in the capacity of a private debtor and without prejudice to its sovereign right to tax income.

My friend has pointed out that the word jama is used in the sense of rent in the Putni Regulation VIII of 1819. It is quite clear from the context that the word is used there in the sense of leases. There are no precedents on the point.

My friend has next argued that royalty on mines has been taxed without protest and he has cited the case of Manindra Chandra Nandi, 1907, I.L.R. 34, Cal. 257, in support of his argument. But there no question was raised about the Permanent Settlement and that for a very good reason. The Government was, and is still, asserting its own right to the minerals and the assessee very wisely preferred to pay a tax on the income from minerals rather than lose the whole income itself by raising the question of the Regulations and inviting perhaps an adverse decision. When there is no mention of the Permanent Settlement in the decision cited last, my friend cannot rely on it on this point.

On the question of taxing profits from a printing press set up on land in a permanently-settled estate, I submit it would be profit from business and liable to tax. It was a perversion of my argument to say that I contended immunity from all taxation."

Sir Benode Mitter on behalf of the Crown contended :

"That there was no such promise made to the actual proprietors of lands which were settled at the time of the Permanent Settlement of Bengal, Bihar and Orissa as alleged on behalf of the assessee; that there are no words in Regulation I of 1793 or in the other Regulations promulgated in the same year from which the inference can be legitimately drawn that there is a statutory obligation not to impose on holders of such lands any other tax whatsoever; that all that was decided in 1793 was that the jama or revenue on lands should be treated as fixed for ever and, therefore, could not be enhanced or altered; that the Legislature is competent to assess the income derived from land in permanently-settled estates, subject to exemptions provided for by the Legislature itself, to Income-tax; that the words used in the charging sections of the Indian Income-tax Act, 1922, are very wide and that they must include income from land in permanently-settled estates, subject to the said exemptions; that the rule about a subsequent enactment of a general nature not being held to affect in any manner an earlier statute on a special subject cannot be pushed too far, inasmuch as the subject-matter of taxation under the later statute is different from the subject-matter of taxation under Regulation I of 1793, *i.e.*, the subject-matters of taxation under Regulation I of 1793, and the Indian Income-tax Act, 1922, are financially and economically different, and that, having regard to the express specification of certain exemptions only, the present assessee's claim must fail."

In Maharaja Birendra Kisore Manikya *vs* Secretary of State 1921, 1, I.T.C. 67, the questions for decision were :—

(1) Is salami payable in respect of tenancy of waste land, and

(2) Is salami payable for recognition of a transfer of a holding from one tenant to another,

agricultural income within the meaning of sec. 2(1) of the Indian Income-tax Act, 1918?

The Acting Chief Justice Sir Ashutosh Mukerjee observed, "When a new tenancy is created in respect of unoccupied waste lands or lands which had been abandoned

by previous tenants, the premium represents essentially the capitalised value of a portion of the rent................". He thus answered the *first question in the affirmative* and thus it became exempt from tax. With regard to the second question he observed, "As regards salami paid for recognition of a transfer of a holding from one tenant to another, it was held in this case that the above consideration did not apply.. . ...the money is paid by the transferee to the landlord to purchase peace so that he may not contest the validity of the transfer." Thus he answered the *second question in the negative* and so it was not exempt from the tax.

In Nawabzadi Meher Banu Khanum's case 1925, 2, I.T.C. 425, this above view in respect of salami was overruled by a Full Bench of the High Court of Calcutta. In this case, the Standing Counsel argued, "that it is not revenue derived from land but from transaction, that is, from the recognition of the transfer and that it is an incident of the transfer and not of the tenancy and therefore does not flow from the land". Justice Greaves did not accept this argument and held that nazar or salami paid by a tenant to a landlord for the recognition of a non-transferable holding is rent or revenue within the meaning of sec. 2(1) (*a*) of the I T. Act of 1922 and that it is exempt from assessment. (Birendra Kishore Manikya *vs.* Secretary of State for India 1920, I.L.R. 48 Cal. 766, in so far as it held the contrary view, overruled).

History of Taxation of Agricultural Income.—"To stabilise the finances after the sepoy mutiny, the Income-Tax Act of 1860 was passed which did not exempt the agricultural income from the permanently settled estates. The Act lasted for five years. In 1869, it was revived and was in force up to 1873 In 1871, the first Road Cess Act was inaugurated in which agricultural income was assessed. In 1877, the Bengal Public Works

Cess Act was imposed. In 1880, both the Cess Acts were consolidated under one Act. In 1878, a License Act was passed as a counterpart of the cess, whereunder all persons carrying on trades, dealings and industries were to take out licenses and pay for the same. In 1886, the Income-Tax Act was passed incorporating in it the principles of the License Tax and agricultural income was exempted on the clear understanding that the lands of the permanently settled estates are already burdened with cess, an additional burden over and above the land revenue. The Cess Act deals with land: the Income Tax Act taps all other property, the cess is for agrarian population whose main occupation is agriculture: income tax is for urban population whose main occupation is trade. In 1918, there was an attempt to include agricultural income in the Income-Tax schedule but it proved abortive, in spite of persuasive attempts by Sir William Meyer, the Finance Member, and Sir George Lowndes, the Law Member. In Bengal, according to the pledge, income-tax on agricultural income can come in if the Road and Public Works cesses go out: both cannot remain on the Statute.

The income-tax on agricultural income, which was levied in 1860 and abandoned after a brief spell of years and which is recommended by the Taxation Enquiry Committee (1924-25), the Simon Commission (1929) and others, and the local rates on profits from land in the shape of cesses which are in existence are supported on the strength of the fact that they do not contravene Regulation I of 1793."*

The question of taxing agricultural income brings the matter of permanent settlement to the forefront. The defence of permanent settlement may be quoted from Mr. R. C. Dutt's Economic History of British India:

" There may be some doubt as to the wisdom of Pitt's per-

* Mr. Sachin Sen's *Studies in the Land Economics of Bengal.*

manent settlement of the land tax in England; there can be no doubt as to that of Cornwallis's Permanent Settlement; in England the settlement benefited the landed classes only; in Bengal the settlement has benefited the whole agricultural community; the entire peasant population shares the benefit and is more prosperous and resourceful on account of his measure. In England the settlement limited the tax on one out of the many sources of national income; in Bengal it has afforded a protection to agriculture which is virtually the only means of the nation's subsistence. In England it precluded the State from drawing a large land tax to be spent in the country for the benefit of the nations; in Bengal it has precluded from increasing the annual economic drain of wealth out of the country. In England it saved the landlord class from add d taxation; in Bengal it has saved the nation from fatal and disastrous famines."

Regarding Taxation of Agricultural Income derived from permanently settled estates, the Chief Justice Dawson Miller in Maharajadhiraj of Darbhanga *vs.* Commissioner of Income-tax said:

"It is argued that the effect of the imposition of income-tax is not to increase the revenue or rent so payable, but it is clear, I think, that the imposition of such a tax is in fact to increase the revenue under another name. The Jama permanently fixed at the date of the Settlement was calculated upon a percentage of the rents and profits at that time derived from the ownership of the land Income-tax is based upon the same rents and profits as they now exist, and it is impossible in my opinion to escape from the conclusion that a tax, under whatever name, upon the same sources of income would increase the duty payable under the name of revenue and which, by the Permanent Settlement, it was agreed, should then be fixed for ever."

Land Revenue, Rent or Tax:

It is not necessary here to enter into the detailed consideration as to whether land revenue is a rent or tax. The Indian Taxation Enquiry Committee Report (1924-25) discussed it fully and states that "The Committee are unanimously of opinion that under both Hindu and Mohammadan rule the State never claimed the absolute or exclusive ownership of the land and definitely recognised

the existence of private property in it" in answer to the two questions, *viz.*,

(1) Did the State claim exclusive proprietary right over land,

(*a*) under Hindu Law?

(*b*) under Mohammadan rule?

(2) Did the British Government succeed to any such right?

The report further states that "the Committee are unanimously of opinion that in the case of lands under permanent settlement, the Government have now no proprietary right and that as regards Khas Mahal estates and waste lands outside the permanently settled areas, they have full proprietorship. On the question of their rights in relation to ryotwari and other temporarily settled tracts, the Committee are divided in opinion . . while, however, the Committee are not of one mind as to the possibility of arriving at an exact and general definition of the position of the landholder in a temporarily settled area, they are agreed that in the generality of cases Zamindars and ryots are respectively the possessors of the proprietary right subject to the payment of land revenue."

Whatever may be the nature of this controversy, the result is of academic interest, but what is of practical value to the landlords directly and the tenants indirectly is that the land revenue is a heavy charge on the income under whatever designation it may be imposed. Sir N. R. Chatterjee, ex-Justice of the Calcutta High Court, observed: "It appears that the owners of the land had to pay cesses, while all other sections of the public had to pay income-tax. That being so, if land is made liable to income-tax, there will be burden (*a*) of revenue under the permanent settlement, (*b*) of road and public works cesses and (*c*) of income-tax, which does not seem to be justifiable, unless other sections of the public are also made liable with cesses".

Name of Provinces.	Total Area in lakhs of acres.	Net cultivated Area—Percentage of total area.	Average Incidence of Revenue per acre on total area	Average Incidence of Revenue per acre of cultivated area.	Value of gross produce per acre	Average rate of rent per acre.	Density of population per square mile.
			Rs. a. p.	Rs. a. p.	Rs. a. p.	Rs. a. p.	
Bengal ..	463	62·4	0 11 3	1 2 0	44 5 0	3 5 0	646
Bihar and Orissa	531	46·8	0 5 7	0 10 4	31 8 0	4 0 0†	411
Bombay .	791	41·6	1 4 9	1 11 6	20 1 0		155
C. P.	639	39·0	0 9 8	1 0 10	20 13 0		246
Madras .	911	36·3	1 10 5	2 3 0	25 9 0	3 0 0	167
Punjab	644	42·6	1 4 4	1 13 5	30 5 0	10 0 0	311
U. P.	725	48·0	1 2 6	1 13 4	31 2 0	6 0 0	445

*** The above figures have been mostly compiled from the Report of the Land Revenue Commission, Bengal, 1938—40.**

***N.B.*—(1) The revenue demand for Bengal has been taken from the Land Revenue Administration Report (1936-37).**

(2) The figures for other provinces have been taken from the Agricultural Statistics of India (1932-33), Volume 1.

(3) During the Bengal Land Revenue Commission's tour in Madras, the Punjab and the United Provinces, the incidence of revenue per acre was ascertained to be Rs. 2-3-6 in Madras; Re. 1-9-0 in the Punjab; and Re. 1-8-0 in the permanently-settled areas and Re. 1-11-0 including remissions, in the temporarily settled areas of the United Provinces

† Mr. Sachin Sen's book "Studies in Land Economics in Bengal."

*** LAND REVENUE SYSTEM OF MADRAS.—the raiyatwari area covers 92,866 square miles, and the permanently-settled area 43,102 square miles. The total of land revenue is 7.19 crores. At the time of the Permanent Settlement in 1802, the Government demand was assessed at half of the gross produce, of which two-thirds was assigned as the Government share and one-third was retained by the zamindars The maximum assessment was to be 30 per cent of the gross produce In 1864 it was decided that the assessment should be made not on the gross produce, but should be half of the net produce, i.e., the value of the gross produce after deducting all costs of cultivation This is still the maximum Government demand.**

Assuming the percentage of agricultural population to be 70, the agricultural population would be 32.7 million. The total net cultivated area is 31.7 million acres It was statd by the Revenue Department that there are 7 million adult agriculturists; and assuming one per family the average area owned by a family would be 4½ acres We were told that the minimum area required for the maintenance of an average family would be about 5 acres, of which 2 to 3 acres must be wet land.

LAND REVENUE SYSTEM IN THE PUNJAB:—The land revenue system was inherited from the Sikh administration In theory the State is the supreme owner of all land and as such it is entitled to a share of the produce Throughout the British administration, and up till 1928, it was considered that the State could fairly claim one-half of whatever was left over after the needs of the peasant-proprietor had been satisfied . . . The Government demand was revised at intervals which were generally 20 years, but recently legislation has fixed the priod at 40 years.

The Punjab is owned by peasant-proprietors, most of whom are small landholders. The agricultural population numbers 13·6

The facts and figures and the actual conditions under which the Jama was fixed and also the grounds on which the assessment made in 1793 was very much an advance assessment, *i.e.*, assessment of future developments, have

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millions according to the Census figure of 1931 out of a total population of 23·6 millions. It seems rather strange that in a province where there are few large towns or industrial areas, the agricultural population is such a small percentage. The cultivated area is 31 million acres. According to the Report of the Punjab Land Revenue Committee, 20 per cent. of the landowners hold less than one acre. Mr. Calvert, a former Financial Commissioner, estimated that 18 per cent. of the landowners possess about half an acre, 40 per cent. 2½ acres, and 26 per cent. 8¼ acres.

LAND REVENUE SYSTEM IN THE U. P.:—As in the Punjab, the State is considered in the United Provinces to be the supreme owner of land and to be entitled to a share of the produce. That share is ordinarily 40 per cent of the proprietor's assets. Previously it was two-thirds of the assets until 1855; half from 1855 to 1895 and between 48 to 45 per cent. from 1895 to 1925. The present rate of 40 per cent is not always taken in practice. The condition of the estate and the number of co-sharer proprietors are taken into consideration, and the revenue may in a few cases be as little as 25 per cent. But 40 per cent. is the legal maximum and the proportion of revenue to recorded rents works out at that figure. The revenue is 7·11 crores and the recorded assets 17·66 crores. The incidence of revenue is 2·1 rupees per acre in the temporarily-settled area, but since the economic depression began, remissions have been allowed both to proprietors and tenants with the result that the incidence of revenue per acre has fallen to 1·7 rupees.

In the permanently-settled area, which is situated in Benares division and part of Azamgarh district and which covers one-tenth of the area of the Province, the incidence of revenue is Rs 1·5 per acre. The revenue amounts to 45·11 lakhs and the total rental demand is 111·04 lakhs. Excluding the proprietors' *khas* land, the incidence of revenue in the permanently settled area comes to 40 per cent. of the assets. The Senior Member, Board of Revenue, told us that there is little difference between the incidence of revenue in temporarily and permanently-settled areas. Including the proprietors' *khas* land in the permanently-settled area, the incidence of revenue would be about 35 per cent. of the assets.

The majority of proprietors hold small estates. There are 12¼ lakhs of revenue payers in the United Provinces as compared with 12 million cultivators. The area under cultivation is 35 million acres so that the average area in the possession of a proprietor is rather less than 30 acres.

been fully and critically dealt with in Professor Radhakumud Mukerjee's History on Indian Land System in vol. II of the Report of the Land Revenue Commission, Bengal, 1938—40. A few paragraphs are given below:—

Land Revenue System of Bengal:—In 1931, the agricultural population was 31·2 million.

The average cultivated area per family of agricultural population is 4½ acres.

Size of an economic holding would be 5 acres for an average family; "the gross cultivated area of the Province amounts to 350 lakhs of acres and the net cultivated area to 289 lakhs of acres. It is further calculated that the value of gross produce per net acre is Rs. 50, while the gross produce per head of the total agricultural population dwindles only to Rs. 46.

46 per cent. of its families hold less than 2 acres each, 11 per cent. less than 3 acres, 9 per cent less than 4 acres, and 8 per cent less than 5, or an economic holding. Thus three-fourths of Bengal's agricultural families are without economic holdings."

These Estimates Not Based on Actuals.—These estimates of the value of land or of the gross ryoti rental of Bengal made by Grant and Shore towards fixing the assessment for Permanent Settlement must, however, be understood to have been merely theoretical or speculative estimates. The ultimate assessment on which the Permanent Settlement was based had no reference to the assets of the ryot. As has been admitted by Sir John Shore himself, "in tracing the progress of the assessment since the acquisition of the Dewani, we find that its amount has generally been fixed by conjectural estimates only."

As a matter of fact, the *jumma* of the preceding year was taken as the standard for fixing the assessment of the following year. At no time during the period from 1765 to 1789 the *jumma* had any relation to the ryoti rental. On the contrary, every settlement made an addition to the previous assessment, because the company needed additional revenue.

Shore also points out that even at the time of the Permanent Settlement the company could not acquire an accurate knowledge of the ultimate value of the lands because it depended upon "a degree of knowledge, experience, and application in the Collectors, which is rarely to be found or attained." Indeed, he was

very much against a Permanent Settlement on the ground that the Company's experience of revenue was still incomplete. He wrote in 1782: "I venture to pronounce that the real state of the districts is now less known and the revenues less understood than in 1776." His plan was in the course of a ten years' settlement to compel the Zemindars to reveal the real revenue capacity of every village and of every Pergunnah by giving lists of villages, showing their boundaries, areas and assets.

INCREASE OF ASSESSMENT SINCE DEWANI.—The amount of revenue assessed at Permanent Settlement was thus determined by the amount of assessment of previous years and not by any calculations of ryoti rental, for which the necessary information or the machinery for obtaining it was not available to the company. At the same time, it has been already seen that the Company's assessment since 1765, showed a steady increase without reference to what the Zemindars or the ryots could pay To recapitulate the history of this assessment, under Verelst as Governor, according to the Fourth Report of the Committee of Secrecy of 1773, the Company's revenue doubled Aliverdi Khan's revenue of Rs. 1,76,81,466. We have already seen that Becher also had reported in 1769 to Verelst to the same effect, stating that "in Aliverdy Cawn's time, the amount of the revenue was much less" and how "this fine country" was being ruined by excessive assessment by which Zemindars who were bound to the ryots by natural ties were ousted by collecting agents called *Aumils* who had no concern for them. Warren Hastings stated that the net collections of 1771 exceeded those of 1768 in spite of famine intervening in 1770. And yet the Quinquennial Settlement of Warren Hastings for the period 1772—1777 was marked by over-assessment based on bids by farmers ousting the Zemindars. The period presents a story of "huge deficits, defaulting Zemindars, deserting ryots, and absconding farmers." All the District Officers were at one in reporting that the country was over-assessed. Middleton considered over-assessment and public auction of farms as causing the famine of 1770 and insisted on "a universal remission of revenue." Reports of distress were made by District Collector even in 1783, *e.g.*, Patterson of Rungpoor or Rooke of Purnea. The distress at last moved Parliament to intervene in the Company's affairs, as already related. Walpole described the Company's "tyranny and plunder as making one shudder," while Chatham described their "iniquities so rank as to smell to earth and

heaven," followed by Burke's violent outbursts in Parliament and impeachment of Warren Hastings.

And yet all this agitation did not materially reduce the assessment. Grant, who is not guilty of under-estimating the assessment, gives the following figures for gross revenue (Mehal and Sayer) claimed in 1765, the year of the Dewani:—

	Rs. in lacs.
Bengal (Dewani Lands)	229
Bengal (Ceded Lands)	41
Bihar	84
Orissa (Midnapore)	14
Total	368

The "Gross revenue actually realised" for 1784 is given as follows:—

	Rs. in lacs.
Bengal (Dewani Lands)	137
Bengal (Ceded Lands)	62
Bihar	53
Orissa (Midnapore)	8
Total	260

If we deduct from this amount the Customs duty which Shore estimates at Rs. 11 lacs for Bengal in 1786, and which may be estimated at Rs. 15 lacs for Bengal, Bihar and Orissa, the land-revenue for the three Provinces will amount to Rs. 245 lacs.

We have seen that assessment was not reduced in spite of the famine of 1770, by which agricultural population was reduced by half as well as the area under cultivation. Adverse conditions continued, as we have seen, up to 1788, and did not allow the country to recover fully. Thus the position is that while the revenue established in 1765, was not a realisable one, and cultivation was considerably contracted during two decades of scarcity that followed, even the revenue of Rs. 245 lacs realised for 1784 was far too high and must have left nothing to landlords and ryots. And yet the revenue demand was pitched by Permanent Settlement at a still higher amount of Rs. 268 lacs (Sicca) on the basis of previous years' collections.

Excessive Assessment Under Permanent Settlement: Taxation of Future Income.—It is clear from an examination of the available data that the revenue which was fixed by Permanent Settlement at the amount of Rs. 268 lacs for Bengal, Bihar and Orissa bore no relationship to what the ryots could pay and the Zemindars could collect from them. The assessment was far ahead of the actual collections. This is shown by the account of assessment which Grant has given. According to Grant, as has been stated above, the gross revenue established for 1765 for Bengal, Bihar and Orissa amounted to Rs. 368 lacs. After the famine of 1770, by which according to Sir W. W. Hunter cultivation shrank by half, the gross revenue must also be taken to have been reduced by half, *i.e.*, to Rs. 184 lacs. If we deduct from this amount the amount of Sayer Revenue which may be roughly taken at Rs. 14 lacs, the total gross Land Revenue Demand should amount to Rs. 170 lacs. Subsequent conditions of depression induced by both famine and flood did not permit the full economic and agricultural recovery of the country up to the time of the Permanent Settlement In fact, " for the first 15 years after the famine," as already stated, *i.e.*, up to 1785, " depopulation steadily increased " The realised revenue for 1784 which amounted to Rs. 245 lacs was thus far in advance of what the land could bear. When an even large amount of Rs 268 lacs was fixed as the revenue demand by Permanent Settlement it far exceeded what should be considered as the fair amount of gross Land Revenue estimated at Rs 170 lacs, as shown above. It is, therefore, quite clear that the assessment of Permanent Settlement was very much an advance assessment, *i.e.*, an assessment which taxed the developments of the future which it estimated roughly at Rs. 1 crore.

Assessment Determined by the Financial Needs of the Company.—The fixing of this amount of assessment was a most difficult undertaking for which Lord Cornwallis proceeded very warily so as to examine fully the evidence before any irrevocable step was taken. Therefore, there were annual Settlements for three consecutive years from 1787, and it was not until the end of 1789, and the first weeks of 1790, that the final decision was made. Unfortunately, Lord Cornwallis had to fix the assessment with reference to the needs of the Company and the views of his Directors rather than facts or justice. Although Cossim Ali's Assessment of Rs. 247 lacs made in 1763 has been described by Shore as

nothing short of "rack-renting and pillage" and was practically an assessment on paper, considering that only Rs. 65 lacs could actually be collected, yet the Company since 1765 had been always trying even to improve upon that assessment, as has been pointed out above. Shore, in his Minute of 18th June, 1789, frankly points out that "in 1786, the revenues of the Dewani lands of Bengal were more than they were for 1765," although conditions created by successive famines and floods had reduced cultivation by half. The fact was that the Company based their revenue demand on their own needs and not on the facts of actual Zemindary receipts or ryoti rental of those days. The practice followed was that the basis of the settlement to be adopted was the assessment of the preceding year while the assessment had gone on increasing since 1765 against the famines and floods of the period. As we have already seen, since 1769, the assessment had been always determined by farming at highest bids. Thus it is not quite correct to assume that the Permanent Settlement demand represented $\frac{10}{11}$ of the rental when the amount of the rental still remained to be ascertained. It is also to be noted that the proportion of $\frac{10}{11}$ is stated to have applied only to Bihar. The assessment in Bengal, as has been explained above, was based on the collections of previous years and there is nothing in the previous history of Revenue Administration to show that the proportion which the revenue bore to the gross assets of each estate had ever been ascertained with any approximation to accuracy.

Assessment of Future Development.—The excessive assessment of the Permanent Settlement was really fixed upon as the present price of a future profit. It amounted to about Rs. 1 crore, as has been calculated above. It was, therefore, quite natural that, in return for this exorbitant assessment, the Permanent Settlement offered to the Zemindars an absolute property in the prospective assets to accrue from the extension of cultivation and reclamation of vast areas of untenanted wastes and jungles then covering more than a third of the total area of the Province as estimated by Lord Cornwallis, and as much as 4/5 as estimated by Grant. According to Pattle, a member of the then Board of Revenue, "The country brought under the Perennial Settlement was for the most part wholly uncultivated. Indeed, such was the state of the country from the prevalence of jungles infested by wild beasts that to go with safety from Calcutta to an adjacent

district, a traveller was obliged to have at each stage four drums and as many torches," to chase them away. Lord Cornwallis knew that he was driving a very hard bargain with the Zemindars by his speculative assessment. In his letter, dated March 6, 1793, he wrote to the Court of Directors explaining "that it was the expectation of bringing the extensive waste and jungle lands into cultivation and reaping the profits of them that have induced many of the Zemindars to agree to the Decennial Jumma assessed upon their lands. If in this way, at any future time, a greater share of the rental went to the Zemindars and Talookdars than they had been accustomed to, he would only welcome it. It would, in the first place, give a real value to landed property which in itself would then be a firm security for the Government revenue (then so badly wanting), and at the same time contribute directly to accumulation of wealth in individuals and thus to general prosperity." . .

It may also be pointed out that the Permanent Settlement was decided upon as the best source of a certain revenue which was very much needed in its time by the Company to build up British Dominion in other parts of India. The Company had then to finance the cost of several wars and other measures which were forced upon them. The Rohilla war, the two campaigns against Tipoo Sultan, the prevention of the hostile Maratha demonstration against Oudh, the mission despatched to Nepal, the reduction of Pondicheri, all these brought the finances of the Company to a low ebb. As R. C. Dutt has pointed out, "in India an Empire was being acquired, wars were waged and the administration carried on at a cost of the Indian people without the British nation contributing a shilling." And the brunt of the cost was borne by the people of Bengal upon whose resources other Provinces like Madras and Bombay had freely drawn to meet the deficits of their administration. At home at this time England was also passing through the worst days, with France, Holland, Spain and Italy allied against her, the United States alienated, and national debt mounting up. R. C. Dutt further stated: "It may be said with strict truth that the conquests of Lord Hastings, like the conquest of Lord Wellesley, were made out of the resources furnished by permanently settled Bengal."

The critics of the permanent settlement hold that since permanent settlement came into force the landlords

have enormously increased their income and as such this increase ought to have been shared by the Government. Such a criticism ignores the fundamental basis of assessment when by the permanent settlement regulations, 90 per cent. of the rental was generally fixed as land revenue. This fundamental basis has been clearly put in Regulation I of 1793 in the following words:

"The Governor-General-in-Council trusts that the proprietors of lands sensible of the benefits conferred upon them by the public assessment being fixed for ever will exert themselves in the cultivation of their lands under the certainty that they will enjoy exclusively the fruits of their own good management and industry and that no demand will ever be made upon them or their heirs as augmentation of the public assessment in consequence of the improvement of their respective estates."

How else to justify the computation of land revenue at 90 per cent. of the rental except by the fact that for the first few decades tax will be almost equal to the income and later on this loss will be recouped when the income will continue to increase, otherwise, is a payment of 14 annas on every rupee as an annual charge conceivable, after the land was handed over to the respective landlords? Obviously, the explanation lies in the fact, that it was expected and stipulated by this arrangement that the landlords would get the necessary relief, as years pass, from improved agriculture, enlarged cultivation, increased productivity of the soil and greater interest of landlords and tenants.

Landholder's Position Examined

To appreciate fully the present relative position of the landholders in view of their increased income from rents we have to examine the total financial charges borne by—

(1) Land income.

(2) Salary, Interest, house, etc., income.

Charges on land income are:

(a) Land revenue or rent,

(b) Cess.

Charges on other incomes are:

(a) Income-tax,

(b) Super-tax.

Though it is difficult to come to any precise conclusion as to the exact incidence of land revenue and cess on land income in India, still, from the foregoing facts and figures together with the figures supplied in the table by the Indian Taxation Enquiry Committee Report (1924-25) in para 437, it can be safely taken that land revenue and cess together range between 25 to 50 per cent. on the rentals, *i.e.*, 4 annas to 8 annas in the rupee. It should be remembered that this charge has no reference to actual cash receipt or realisations and is at a flat rate on every landlord's income whether it is Rs. 5,000 or Rs. 25,000 or Rs. 50,000 or Rs. 1,00,000 or over, while in the cases of such incomes of persons other than landowners, the rate scales up from 9 pies to 30 pies plus Super-tax beyond Rs. 25,000.

Illustration 3—

From the following:—

(1) Income Rs. 8 000, Landholder pays Rs. 2,000 to Rs. 4,000. Income Rs. 8,000, others pay, say, Rs. 400.

(2) Income Rs. 20,000, Landholder pays Rs. 5,000 to Rs. 10,000. Income Rs. 20,000, others pay, say, Rs. 2,000.

(3) Income Rs. 1,00,000, Landholder pays Rs. 25,000 to Rs. 50,000. Income Rs. 1,00,000, others pay, say, Rs. 26,000.

It is clear that in the cases of smaller incomes the disparity between the two impositions is indeed very large but as the incomes move upwards the disparity is narrowed down, until in the cases of incomes over a lakh, the

income-tax payable and the land revenue payable are close to each other.

Taking the cases of incomes below one lakh, it can therefore be safely held that the land income is subjected to much greater charge by way of land revenue and cess than the charge upon other incomes by way of income-tax and super-tax. The landlords should regard the greater part of the excess charge as payments towards the right of enjoying the property for a long term of years or in perpetuity obtained from the State

Suggestion:

Under these circumstances if an imposition of income tax on agricultural income becomes a necessity for the sake of provincial revenue the solution undoubtedly lies in imposing an income tax on agricultural income where it exceeds Rupees One Lakh Only at this stage or a little earlier, a levy of income tax in addition to land revenue and cess can be justified

The question of taxing agricultural income is a very difficult one On the one hand, agricultural income is exempt from income tax by the present Income Tax Act and on the other hand, by the Government of India Act, 1935, this item has been transferred to be a provincial subject for taxation The Provincial Governments while taxing agricultural income will do well to considerably modify its present definition Agricultural income under the present definition covers many subjects which can in no way be called either agriculture or horticulture, etc. The case decisions have exempted Zamindars' palaces and rents and interests arising out of usufructuary mortgage. The case of forest is admittedly a difficult question, still, the subject requires careful consideration. It must also be admitted that where an organisation (limited company or otherwise) is for manufacture and industry (organisation

not being agricultural) no exemption should be given on the ground that in the initial stages raw materials were agricultural produce. The tea, sugar, coffee industries and such other industries as derive income partly from cultivation and partly from manufacture are instances to the point. The exemption given at present to tea industry is hardly justifiable; it is an industrial venture pure and simple. A quotation from Taxation Enquiry Committee Report will be quite sufficient:

"The case of the tea planter or other manufacturer who derives his income partly from cultivation and partly from manufacturing the produce so derived has been settled by an arbitrary rule. In view of the systems on which much of the land under plantation is held, it seems to the Committee that these assessees may be deemed fortunate in securing the benefit of the exemption."

In this connection, attention should be directed to paragraphs 135, 136 and 137 of the Report of the Land Revenue Commission, Bengal.

"135 Agricultural income-tax – There appears to be no legal bar to the imposition of an agricultural income-tax, and we concur with the view expressed by the Indian Taxation Enquiry Committee that agricultural incomes should not be exempted from taxation The Government of Bihar has imposed a tax on agricultural incomes since 1938, and a similar measure has been under contemplation of the Governments of Assam and Madras. In Bihar, the tax has been imposed on incomes over Rs 5,000, after deducting revenue or rent, cess, collection charges, and various other items Income-tax was imposed from 1860 to 1865, and again from 1869 to 1873 on incomes whether they were wholly or partly derived from agriculture Under present conditions, income-tax is paid on incomes, to the Government of India A tax on agricultural incomes would be paid to provincial revenues, and therefore a person whose income from agricultural and non-agricultural sources was just below the limit in either case, would escape assessment altogether, although his total income exceed the assessable limit. This might be avoided if an arrangement could be made between the Central and Provincial Governments to collect and divide the tax which might be assessed in such

case. The Indian Taxation Enquiry Committee contemplated such an arrangement, provided that it was administratively feasible. There is therefore a case for fixing the limit below Rs. 2,000 and we propose that Rs. 1,000 should be the limit, unless an arrangement can be made to collect the tax on incomes exceeding Rs. 2,000 which are partly agricultural and partly non-agricultural.

136 Agricultural cess —Agricultural cess is an alternative method of raising revenue from the land It could either be imposed on the land as a rate per acre, to be paid by all classes of rent-receivers, including occupancy raiyats who cultivate through bargadars; or it might be assessed on the net income of all rent receivers, in which case it would amount in practice to very much the same as an income-tax We are not in favour however of an agricultural cess, chiefly because of the extreme difficulty under present conditions of devising any means for its collection, except through the proprietors and tenure holders, and as a surcharge on rent It would have to be collected n the same way as road and public works cess, and educational cess Realisation of educational cess has not proved satisfactory, owing to the difficulty which the landlords are experiencing in its collection, and we feel that under present conditions it would be useless to recommend the addition of a further cess

137 Recommendation --We should prefer an agricultural income-tax, to be imposed as a transitional measure until the scheme of State acquisition is effected, or as a permanent measure, if Government consider that State acquisition should not be undertaken for financial or other reasons We are strongly of opinion that if agricultural income-tax is imposed, it should be applied solely for the improvement of agriculture, or for projects connected with agricultural improvement

Another important aspect which has to be taken into account in connection with this question of the assessment of the agricultural income is the possible extension of the agricultural industry to various subsidiary and allied fields for which the conditions appear to be favourable in India. There is now expected a development of new agricultural enterprises in the form of intensive scientific farming, orcharding, dairying, poultry farming and

general rearing of livestock. The growth of such new enterprises should not be retarded at the outset by taxation. *Suggested exemptions*, therefore, may proceed on the following lines:

(1) Income from agriculture, farming, etc., by cultivation of agricultural produce arising to the primary growers.

(2) Proceeds from growing trees or from orcharding, etc., if the owner is a whole-time man engaged principally in this agriculture.

(3) Proceeds from poultry farming and rearing of livestock, dairying if the owner is a whole-time man engaged principally in animal husbandry:

Provided that the proceeds from (1), (2) and (3) above received by any person other than the primary growers (namely, agriculturists, orchard owner, poultry owner, dairy owner, etc.) be deemed to be non-agricultural.

Provided further that the proceeds from (1), (2) and (3) will cease to be non-taxable from the first day of the owner's accounting year if their organisations are converted into a joint-stock company other than into a private limited company.

Provided further that not less than ⅓ of the total number of members constituting the private limited company must be principally engaged in that agricultural undertaking.

Provided further that a manufacturer will be debarred from claiming any exemption on any portion of the proceeds or profits in respect of agricultural commodities undergoing agricultural operations or processes at any earlier stage.

LAND UNDER PERMANENT SETTLEMENT—

Income from *such* land which is used for agricultural purposes will come under section 4(3)(viii).

Income from *such* land which is not used for agricultural purposes is not exempt. (Privy Council in Probhat Barua's case, 1930.)

THE CALCUTTA HIGH COURT held that Permanent Settlement Regulation of 1793 does not give any exemption from liability to income-tax (Emperor *vs.* Probhat Chandra Barua, 1924, A I R, Cal. 668.)

THE MADRAS HIGH COURT held that any income derived by a Zamindar from forests and fisheries in his zamindari held under a permanent settlement under Madras Regulations of 1802 was not liable to income-tax. (Secretary of State *vs* Zamindar of Singampatti, 1922, 1, I.T.C. 181.)

THE PATNA HIGH COURT held that income from jalkars, hat, etc., which were included in the assets on which permanent settlement was based were not liable to income tax. (Maharaja of Darbhanga *vs* C I T, Bihar, 1924, 1, I T.C., 303.)

THE ALLAHABAD HIGH COURT held that such income would be liable to income tax as it has not been specially exempted by the Act. (Shib Lal Gauga Ram *vs* C.I T., U.P., 1927, 2, I T.C., 425.)

These conflicting decisions have been set at rest by the Privy Council in the Raja Probhat Chandra Barua's case (1930). The present position therefore is that on the ground of permanent settlement, no exemption from income-tax is allowed. *Exemption is allowed only to agricultural income whether from permanently settled land or otherwise.* There is a good deal of confusion in the public mind on this issue, but the fact remains that permanent settlement *as such* has nothing to do with the exemption of agricultural income as defined in the present Income-Tax Act.

In Maharaja of Darbhanga *vs.* C.I.T., Bihar, 1928, 3, I.T.C. 156, it was held that the dwelling house of which the guest house

was a part and parcel being required by the assessee as Zamindar, the exemption of the annual value of this guest house was allowed as agricultural income.

In Rani Saltanat Begam *vs.* C.I.T., U.P., 1933, I.T.R., 379, the assessee, one of the widows of the Raja of Nanpara Estate in Oudh, was awarded a monthly maintenance allowance of Rs. 4,000 under a compromise of the court, this allowance formed a charge on the Estate. She claimed exemption as agricultural income. It was decided that maintenance allowance was not an agricultural income and therefore taxable.

In the case of Raja Rajendra Narayan Deo *vs.* C.I.T., Bihar 4, I.T.C. the assessee derived bulk of his income from agricultural rents. He had a palatial building for his residence extending over 40 square miles with quarters for zamindari staff and a guest house. The Income-Tax Officer found out a proportionate valuation of the palace not required for agricultural purposes. It was decided that all these buildings, etc., were exempt under agricultural income.

In Maharaj Kumar Gopal Saran *vs.* C.I.T., Bihar, May, 1935, I.T.R. 237, Maharaj Kumar took a loan from Y and some time later transferred a portion of his estate towards payment of assessee's debts, a cash payment and an annuity to himself for his life. It was held by the Privy Council that the annuity was neither rent nor revenue derived from land and therefore did not come within agricultural income.

In C.I.T., U.P. *vs.* Lal Suresh Singh, September, 1935, I.T.R. 356, Raja Avadhesh Singh of Kalakankar, the holder of an impartible estate in Oudh, and the elder brother of the assessee, by an agreement, contracted to pay the assessee Rs. 600 p. m. for his life time in consideration of assessee's giving up all claims in the estate. The assessee contended that the allowance came under agricultural income. The Oudh Chief Court decided otherwise, on the basis of the Maharaj Kumar Gopal Saran's case. Had the assessee based his case on the decision in Maharaja Visweswar Singh of Darbhanga's case (April, 1935, I.T.R. 216), he would probably have succeeded on the ground that the allowance would come under "a receipt as a member of the Hindu Undivided Family."

A zamindar took promissory notes from his ryots for the rent due. It was held that the interest which accrued on the

pronotes was not agricultural income. By the new contract, the liability ceased to be one for rent and became a loan (C.I.T. Madras *vs*. Zamindar of Kirlampudi, 1932, I.L.R., 55, Mad., 830).

In Raja Bijoy Singh Dudhuria's case, 1933, I.T.R. 135, an allowance was made to the widow of a coparcener (assessee's step mother). This allowance was deducted from the assessee's income for taxation purpose If it were a discharge of the assessee's personal obligation, then this deduction would not have been allowed; as it was not so, the allowance was deductible.

In C.I.T., Bihar *vs*. Sir Kameshwar Singh, 1934, I.T.R., 107, the assessee carried on money lending business who advanced a large sum to another estate on the security of certan properties Two bonds were executed, one being a lease of indenture being called "zarpeshgi lease with usufructuary mortgage" and the other a thica or indenture of lease Is this income agricultural?

"In a *zarpeshgi lease* properly so called, there is an advance to the lessor in consideration of which the lessee is given possession of the land for a term during which he recoups himself for the sum advanced and interest out of the profits of the land of which he is put in possession There is no question of redemption upon paying off an advance The lease terminates at the expiration of the term and the lessor may thereafter re-enter" (Mitra's Transfer of Property Act)

"In other words, it is argued that there is a loan, there is security of the property for the loan, there is possession of the property and the loan is being liquidated out of the usufruct of the property until the loan is satisfied, and merely because the words "thica rent" and "thica profits" are used in the indenture for the purpose of allocating the usufruct, it cannot be held that the transaction is not a usufructuary mortgage." (Courtney Terrell, C.J.)

Justice Das in the case, Rajniti Prasad Singh *vs*. C.I.T., Bihar and Orissa, 4, I.T.C. 276 observed:

"On the other hand it may be urged with equal force that a mortgage does not cease to be a mortgage because possession is delivered to the mortgagee and that the essence of a mortgage simple or usufructuary is that a loan is advanced and security

given for the due repayment of that loan and that the income derivable by the mortgagee whether in possession or not is interest on the money advanced and is the return from money not rents, issues and profits from the lands mortgaged and therefore not a return from the land. As I have said the question is a difficult one upon which much may be said on either side."

The learned Chief Justice observed as follows:

" It is contended on the strength of two earlier decisions to be hereinafter referred to that the income of a usufructuary mortgagee as such is agricultural income and exempt from tax. As I shall point out, having regard to the facts of the case this broad question does not arise and in spite of the weight of opinion in favour of a negative answer I would reserve my own view on the subject."

The judgment of Courtney Terrell, C.J., ran as follows:—

" . . On the part of the assessee it is contended that the source of the income must be considered as the rent and other payments derived from the tenants of what is admittedly land used for agricultural purposes. In my opinion, the latter argument must prevail. The source of the income must be considered in its proximate rather than in its ultimate significance. The estate was in every sense in the possession of a landlord of land used for agricultural purposes. We are not concerned with the intention of the assessee in making this investment. It is conceivable that he may have intended ultimately to purchase the mortgaged property in order to add it to the rest of his zamindari rather than to obtain the repayment of his loan in the ordinary way. To accede to the suggestion that we should look at the ultimate rather than the proximate source of the income would involve insuperable difficulties. It is perfectly clear that if the mortgage had been a simple mortgage and the mortgagor had remained in possession and paid this sum by way of interest to the mortgagee, then it would have been taxable by way of income arising out of the transaction. The assessee would have derived the income not from the land but from the mortgagor. Similarly if the assessee under a contract of usufructuary mortgage had leased the land back to the mortgagor so that the latter remained in possession and in relation to the cultivators of the soil stood in the position of a landlord, the rent payable by the mortgagor would merely have

been by way of interest payable to the assessee and would have been taxable. We are dealing with a fiscal statute and accordingly are not concerned either with the intention of the legislature or with the spirit of the legislation. In such cases the Court has merely to regard the letter of the law unless such considerations are clearly specified in the enactment for the guidance of tribunals. In this case there are no such guiding principles stated and we have to follow the enactment strictly."

Justice Kulwant Sahai observed: "The Department seems to be under the impression that the income derived from usufructuary mortgage is not taxable but if the transaction be treated as being other than usufructuary mortgage the income derived would be taxable. In my opinion the question whether the income is or is not taxable does not depend upon the transaction being a usufructuary mortgage or otherwise The question for consideration is whether the income derived by the assessee from the transaction in question is or is not an agricultural income under section 2, sub-section (1) (a) of the Indian Income Tax Act If it is such agricultural income there can be no doubt that it is not taxable The principal question, therefore, is the first question which depends on a finding whether the income is or is not agricultural income "

Held this income is agricultural

In the Commissioner of Income tax, Bengal *vs*. Shaw, Wallace & Company, 1932, 6, I.T C. 178, the following three questions were referred to the Privy Council :—

(*a*) Was not the sum of Rs 9,83,361 which had been included in the total income of the assessees for purpose of assessment for 1929-30, in the nature of a capital receipt and therefore not income, profits or gains within the meaning of the Income-Tax Act?

(*b*) If it could be said to be income, profits or gains within the meaning of the Act, was it liable to be assessed under either of the sections 10 and 12 of the Act, in as much as (1) it was not the profits, or gains of any business carried on by the assessees within the meaning of section 10 of the Act, nor (2) income, profits or gains from other sources within the meaning of section 12 of the Act?

(c) In the alternative, was not the payment of Rs. 9,83,361 *ex gratia* payment in the nature of a present from the oil com-

panies in question and was it not, therefore, exempt under section 4(3) (*vii*) of the Act?

The Privy Council observed:

The object of the Indian Act is to tax "income", a term which it does not define. It is expanded, no doubt, into "income, profits and gains", but the expansion is more a matter of words than of substance. Income, their Lordships think, in this Act connotes a periodical monetary return "coming in" with some sort of regularity, or expected regularity, from definite sources. The source is not necessarily one which is expected to be continuously productive, but it must be one whose object is the production of a definite return . . . . Some reliance has been placed in argument upon section 4 (3) (*v*) which appears to suggest that the word "income" in this Act may have a wider significance than would ordinarily be attributed to it. The sub-section says that the Act "shall not apply to the following classes of income," and in the category that follows cl. (*v*) runs:—

"Any capital sum received in commutation of the whole or a portion of a pension, or in the nature of consolidated compensation for death or injuries, or in payment of any insurance policy, or as the accumulated balance at the credit of a subscriber to any such Provident Fund."

Their Lordships do not think that any of these sums, apart from their exemption, could be regarded in any scheme of taxation as income, and they think that the clause must be due to the over-anxiety of the draftsman to make this clear beyond possibility of doubt. They cannot construe it as enlarging the word "income" so as to include receipts of any kind which are not specially exempted. They do not think that the clause is of any assistance to the Appellant.

Following the line of reasoning above indicated, the sums which the Appellant seeks to charge can, in their Lordships' opinion, only be taxable if they are the produce, or the result, of carrying on the agencies of the oil companies in the year in which they were received by the Respondents. But when once it is admitted that they were sums received, not for carrying on this business, but as some sort of solatium for its compulsory cessation, the answer seems fairly plain. . . .

For the reasons given their Lordships are of opinion that question (*a*) was rightly answered by the High Court in favour of

the assessee. No objection has been taken to the form of the answer or to its sufficiency, and it would seem unnecessary, therefore, *to deal with the other two questions*."

Sub-section (6) "company" means a company as defined in the Indian Companies Act, 1913, or formed in pursuance of an Act of Parliament or of Royal Charter or Letters Patent, or of an Act of the Legislature of a British possession, and includes any foreign association carrying on business in British India whether incorporated or not, and whether its principal place of business is situate in British India or not, which the Central Board of Revenue may, by general or special order, declare to be a company for the purposes of this Act.

Some important definitions are given below .

(1) " Company " means

(*i*) companies as defined in the Indian Companies Act, 1936,

(*ii*) companies formed in pursuance of an Act of Parliament,

(*iii*) companies formed by Royal Charter or Letters Patent,

(*iv*) companies formed by an Act of the Legislature of a British possession,

(*v*) any foreign association carrying on business in British India whether incorporated or not and whether its principal place of business is situated in British India or not, which the Central Board of Revenue may, by general or special order, declare to be company for the purposes of the Act.

NOTE.—(*a*) This definition includes all companies constituted in the dominions of the Crown.

(*b*) A similar Companies Act in force in a Native State in India will not come under the definition.

(*c*) Central Board of Revenue may declare any organization as a "Company" for the purposes of the Act.

(2) "Firm," "Partner" and "Partnership" have the same meaning respectively as in the Indian Partnership Act of 1932.

> "A partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all."

(3) "Principal officer," used with reference to a local authority or a company or any other public body or *any* association, means--

(*a*) the secretary, treasurer, manager or agent of the authority, company, body or association, or

(*b*) any person connected with the authority, company, body or association upon whom the Income-tax Officer has served a notice of his intention of treating him as the principal officer thereof.

NOTE.—"Manager" here has been used in a broad sense and that the liquidator should be treated as principal officer of the company. It is not necessary to take recourse to section 41 for holding liquidators liable. (C.I.T., U.P. *vs*. Official Liquidator, Agra Spinning and Weaving Mills Co., Ltd., 1934, I.T.R. 78.)

(4) "Total income" is a technical expression which determines liability of an assessee once for all and fixes the rate. It means total amount of income, profits and gains referred to in section 4(1) subject to section 16.

(5) "Total world income"—This refers to Non-residents. In computing the total income of a resident, Rs. 4,500 will be allowed as a deduction from unremitted foreign income. In computing the total

income of a non-resident, no such deduction will be allowed.

NOTE —(*i*) Total income is the total amount of assessable incomes from all sources.

(*ii*) The methods of arriving at the assessable incomes differ with different sources of income.

(*iii*) With regard to incomes from some sources there are no deductions and with regard to others there are deductions allowed before arriving at the assessable income.

S. 2(6A) 'dividend' includes—

(a) any distribution by a company of accumulated profits, whether capitalised or not, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company;

(b) any distribution by a company of debentures or debenture-stock, to the extent to which the company possesses accumulated profits, whether capitalised or not;

(c) any distribution made to the shareholders of a company out of accumulated profits of the company on the liquidation of the company:

Provided that only the accumulated profits so distributed which arose during the six previous years of the company preceding the date of liquidation shall be so included; and

(d) any distribution by a company on the reduction of its capital to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April, 1933, whether such accumulated profits have been capitalised or not;

Provided that 'dividend' does not include a distribution in respect of any share issued for full cash consideration which is not entitled in the event of liquidation to participate in the surplus assets, when such distribution is made in accordance with sub-clause (c) or (d).

Explanation.—The words 'accumulated profits', wherever they occur in this clause, shall not include 'capital profit."

Section 2(6A)(a)—Bonus Share.

(1) Accumulated profits when capitalised become shares. When these shares are distributed as bonus, it is then a distribution of capitalised profits and such a distribution of bonus shares does not entail any release by the company to its shareholders any asset of the company (it is merely a transference from one account to another, *i.e.*, from P & L A/c or Reserve A/c to share capital A/c). Such distribution of bonus shares will not come under dividend and will not be assessable.

In Bouch *vs.* Sproule, 1887, 12 A.C., 385 (though it was not a revenue case) it was decided that if a company capitalised its profits, the distribution of bonus share was income.

In Commissioner of Inland Revenue *vs.* Blott, 1921, A.C. 171, it was decided that a bonus out of its undivided profits in the shape of bonus share was a capital distribution and not income in the hands of the assessee.

(2) Accumulated profits if not capitalised will remain either in the P & L credit balance or in the Reserve (Revenue Reserve and Capital Reserve to be distinguished). Distribution of profits not capitalised means the usual dividend in cash which is a release of asset. Hence such distribution of cash comes under dividend and will be assessable.

(3) The word ' If ' does not imply the sense of ' to the extent that.' A company decides to distribute its accumulated profits of Rs. 30; it issues bonus of Rs. 20 out of accumulated profits and pays cash for the balance of Rs. 10. This transaction entails release of asset to the extent of Rs. 10 but entails no release in respect of bonus

payment. The bonus share of Rs. 20 will not come under dividend but the payment of Rs. 10 will come under dividend.

Section 2(6A)(b)—Bonus Debenture.

(*a*) Where the distribution has taken the form of Debentures (*i.e.*, where the profits are not capitalised or where the profits being capitalised into ordinary shares or preference shares are reconverted into Debentures) it will come under dividend. In short, bonus debenture is taxable.

(*b*) It is noteworthy that the amount to be considered dividend is the amount of the accumulated profits not the amount so distributed as Debentures

(*c*) Debenture capital is a loan to the company which is distinctly of a different character from share capital.

(*d*) The idea evidently underlying the above 1 and 2, is that a differentiation is to be made between Share and Debenture Although Share capital is the actual capital and Debenture capital is merely loan capital, still, both in the English Act and in the Indian Act, the fundamental conception of law, until recently, was that both Share and Debenture are of capital nature and as such not taxable. Strictly following this view, if bonus out of profits which are revenue earnings is converted into Share or Debenture, both should come under the enlarged definition of Capital But here the new Act draws a distinction between Share and Debenture for taxation purpose. Thus the Act recognises the immunity from taxation of the bonus share as it becomes Capital to the extent that the revenue earnings are transformed into capital, leaving the revenue earnings returned or given to the shareholder in cash or in debenture liable to the tax.

In justification of the new Act, it should be pointed out that Debenture is never a part of the capital in the

true legal sense; it only serves the purpose of capital but it is a loan pure and simple. Debentures would be paid off to the Debenture-holders and therefore it is quite reasonable from one point of view to treat Debentures differently from shares.

In Commissioner of Inland Revenue *vs.* Fisher's Executors, 1926, A.C. 395, a company distributed its accumulated profits to its ordinary shareholders. Justice Rowlatt decided that the company "issued it to their shareholders by way of giving them at once their share of these undivided profits."

The Court of Appeal reversed this decision and followed Blott's case. The House of Lords agreed with the decision of the Court of Appeal, namely that these debentures were not income in the hands of the Share-holders.

Section 2(6A)(c) Distribution in Liquidation.

Dividend will include that amount which may be distributed in liquidation from the accumulated revenue profits provided such profits arose during 6 years preceding the date of liquidation. (The date of liquidation is the commencement of liquidation.)

The sub-section is sufficiently complicated and also confusing. In the winding up of a company, the undivided or accumulated profits cease to be profits and become assets. In Inland Revenue Commissioner *vs.* George Burrell, 1924, 2K.B. 52, it was decided that when the limited companies' undivided profits were distributed among the shareholders, Super-tax on this was not allowed on the ground that on winding up, the undivided profits become assets. As this is so, how can there be distribution of accumulated *profits*?

The explanation must be that the liquidator conducts his liquidation work and makes the necessary payments to creditors and shareholders out of the assets in which are merged the accumulated profits which have lost, in liquidation, the impress or character of profits. But for

income-tax purposes, the amount of these accumulated profits shall be considered as dividend without any reference as to how the liquidator treats them.

Section 2(6A)(d) – Distribution Effecting Reduction of Capital.

This sub-section contemplates a case where a company does not distribute its accumulated profits in order to avoid shareholders' payment of Super tax on the distribution, but a sum (in lieu of profits) equal to the accumulated profits with the impress of capital is distributed to the shareholders thus effecting reduction of capital. Such a distribution not of accumulated profits but apparently of capital sum is to be treated as dividend But such distribution as may come within the following category will not be considered dividend and hence not assessable

DISTRIBUTION--

(*a*) where share was issued for cash.

and (*b*) where, in the event of liquidation, no right arises to participate in the surplus assets.

This distribution raises a very complicated question, *viz.*, the question of participation of surplus assets

The first difficulty is what is surplus asset?

Lord Lindley in his treatise states that "the expression "surplus assets" is ambiguous, and when used in articles of association may mean either the surplus remaining after payment of the debts and liabilities of the company and the costs of the winding up, or the surplus remaining after payment of these debts, liabilities, and costs, and after recouping the paid-up capital subscribed by the shareholders.

Although *there may be surplus assets to be divided*, it by no means follows that the company has

made any profit. If the surplus is not sufficient to return to the shareholders the amount of capital paid up by them, there has been a loss; and the question to be decided in distributing the surplus is then how that loss is to be borne. If, on the other hand, the surplus is more than sufficient to return to each shareholder the capital paid up by him, there is a profit, and the question then is how the profits are to be shared.

If there has been a loss, the holders of shares entitled to a preference only in respect of dividends payable out of profits are not as a rule entitled to any preference in respect of the surplus assets If there has been a profit, the question is more difficult, and depends upon whether (according to the company's Act, charter, deed, or articles) the excess of the assets over the capital paid up, though profit in one sense, constitutes a fund divisible as profits amongst the holders of the preference shares "

According to the recent decision in William Metcalf & Sons, Ltd (1933, 1 Ch. D. 142) Justice Eve observed "Surplus assets are part and parcel of the property of the company not required for the discharge of its liabilities or for returning to the shareholders the capital they have paid up; they are part of the joint-stock or common fund which, at the date of the winding up, represented the capital of the company, but they are no part of the repayable capital. It has *ex hypothesi* been repaid before they came into existence. These assets are distributable amongst the contributories in

accordance with their contractual rights *inter se*, and the question I have to determine is the true interpretation of these rights in this case. In approaching the solution of this question it is to be borne in mind that every person who becomes a member of a company, limited by shares of equal amount, becomes entitled to a proportionate part in the capital of the company and, unless it be otherwise provided by the regulations of the company, entitled as a necessary consequence to the same proportionate part in all the property of the company. Preference shareholders are members of the company, and as much shareholders in it as the ordinary shareholders are, and they must be treated as having all the rights of shareholders except so far as they renounced those rights on their admission to the company It is for the ordinary shareholders here to establish that the preference shareholders renounced their rights to participate in the surplus assets now distributable "

From the above, it is clear that the surplus assets should be interpreted as that sum which remains after paying debts, liabilities, costs and contributories Such shareholders who, by their Articles of Association, have no right to participate and who paid cash for the shares, will not have to pay tax on distribution under (*c*) and (*d*).

This may be illustrated :--

In respect of fully paid up shares of Rs 10,000 a company returned to his shareholders Rs. 3,000 which was in excess of its requirements thus effecting reduction of capital to the extent of accumulated profits of Rs 3,000.

(1) Shareholders who have no right to participate, etc., will not be deemed to have received any dividend even

though a distribution to them of a portion of Rs. 3,000 has taken place. When they will be returned their capital, they will receive no more than their actual capital that is the balance representing their portion of Rs. 7,000.

(2) Shareholders who have right to participate will be deemed to have received dividend in the distribution of the portion of Rs. 3,000 and therefore this amount is assessable. When they will be returned their capital, they will be entitled to participate in the surplus asset, which assuming to be Rs. 5,000 will be assessed. Therefore, the assessment will be on Rs. 3,000 and Rs. 5,000 in all.

NOTE :- (1) There is a broad distinction between Revenue profits and Capital profits; but within the expression, Revenue profits, are some items which are treated as of Capital nature during the usual currency of the business as they are not profits in trading *e.g.*, transfer receipts, premium income, etc. True capital profits are the sale proceeds of any capital asset of the business.

(2) This section on dividend demands a careful analysis of the share capital account. In Liquidation or in Reduction of capital, detailed particulars about distribution of assets of the company are essential.

(3) One has to remember the necessity of this complicated definition of Dividend It is clear that so far as Income tax is concerned, all profits, as soon as they arise in the P and L A/c, will be taxed; therefore, accumulated profits are already income-taxed. But the point at issue is the avoidance of super-tax in the hands of an individual. In many cases, it is possible for the company owners to withhold any distribution among themselves. Even when they distribute, they do so in the form of bonus shares and bonus Debentures, thus converting them (the revenue earnings) into capital. This section is designed to treat such distribution in the form of Debentures and shares as distribution of dividend.

We have recast and expanded the definition of "dividend," primarily in order to ensure that no distribution falling under this head shall be taxed unless there is a release of assets. Under the amended definition a debenture will when issued be treated as a dividend but an ordinary bonus share will not be liable to taxation until it is actually paid off. The definition further secures that accumulated profits distributed on the liquidation of the company shall only be included in dividend for the purposes of taxation, if they arose within six years of the liquidation. Clause (*d*) of the revised definition provides for the case in which a company tries to disguise a distribution of profits as a reduction of capital. The words inserted in the new sub-clause (c) of clause (11) of section 2 of the Act by clause 2(c) (iii) of the Bill merely make a correction overlooked in the Bill, and necessary in view of the revised wording of section 10 of the Act. (Select Committee Report.)

Under sec. 2(6C) Income includes

(1) anything which falls under dividend,

(2) anything which is a profit received in lieu of salary,

(3) any amount deemed to be profits under sec. 10 (2)(vii) second proviso

(4) profits of any mutual insurance company in accordance with rule 9 of the schedule

Section 2. (11) "previous year" means in respect of any separate source of income, profits and gains—

(a) the twelve months ending on the 31st day of March next preceding the year for which the assessment is to be made, or, if the accounts of the assessee have been made up to a date within the said twelve months in respect of a year ending on any date other than the said 31st day of March, then at the option of the assessee the year ending on the day to which his accounts have so been made up:

Provided that where an assessee has once been assessed in respect of a particular source of income, profits and gains, he shall not in respect of that source

exercise this option so as to vary the meaning of the expression 'previous year' as then applicable to him except with the consent of the Income-tax Officer and upon such conditions as the Income-tax Officer may think fit; or

(b) in the case of any person, business or company of class of person, business or company, such period as may be determined by the Central Board of Revenue or by such authority as the Board may authorise in this behalf; or

(c) where a business, profession or vocation has been newly set up in the financial year preceding the year for which assessment is to be made, the period from the date of the setting up of the business, profession or vocation to the 31st day of March next following or to the last day of the period determined under sub-clause (b), or, if the accounts of the assessee are made up to some other date than the 31st day of March and the case is not one for which a period has been determined by the Central Board of Revenue under sub-clause (b), then at the option of the assessee, the period from the date of the setting up of the business, profession or vocation to such other date:

Provided that when such other date does not fall between the setting up of the business, profession or vocation and the next following 31st day of March, it shall be deemed that there is no previous year; and

when the assessee is a partner in a firm, 'previous year' in respect of his share of the income, profits and gains of the firm means the previous year as determined for the assessment of the income, profits and gains of the firm.

PREVIOUS YEAR

NOTE.—(1) The salient points in the definition of PREVIOUS YEAR in the Act before the amendment of 1939 were :—

(i) 12 months ending 31st March, or

(*ii*) if the accounts are made up to any other date within 31st March, then the year ending this date (to which his accounts are made up) This is the assessee's first option.

(*iii*) Any subsequent option of the Assessee may be accepted by I T O on conditions and terms which he may think necessary

(*iv*) Previous year is only one for each assessee.

(2) PROVISION OF THE OLD LAW IN RESPECT OF CHANGE OF ACCOUNTING YEAR

Suppose a business closes its books on 31 3 36 In 1936 37 assessment, profits up to 31 3 36 will be included Now suppose a change in the accounting year to 31 12 36 is desired Then for 1937 38 assessment the I T O will be required to include profits for the period 1 1 36 to 31 12 36 Thus profits for 3 months, *i e*, 1 1 36 to 31 3 36 will come under assessment twice *This double taxation is remedied by the new Act*

Then again suppose a business closes on 31 12 35 Thus for the assessment of 1936 37 the profits up to 31 12 35 will be included If now a change in the accounting year to 28th February is desired, then in the following assessment year 1937 38 14 months from 1 1 36 to 28 2 37 will be included

(3) CHANGES EXPLAINED.

The main change is that each source has a previous year.

In Abu Baker Abdul Rahman (Bombay), it was clearly brought out and decided that the assessee will, under no circumstances, be allowed to adopt two different previous years. But according to the new Act, as each *source* of income (as distinct from each *assessee*) will have its own previous year, the practical implication is given below :—

Illustration 4.

(*i*) A's business closes its books on 9. 11. 36.

(*ii*) A's House Property income received on 31.12. 36.

(*iii*) A's interest on securities received on 15. 3. 37.

(4) 1937-38 Assessment year.

1936-37 Previous year

(A) Old law (before amendment of 1939).

(*a*) If the assessee chooses 15. 3. 37 as the closing year then all the items (*i*), (*ii*) and (*iii*) will be included in 1937 38 assessment, all the three having fallen within the previous year 1936 37

(*b*) If the assessee chooses 9 11. 36 as his closing year then the income (*ii*) and (*iii*) though within the previous year will not come into 1937 38 assessment, for the reason that these dates are subsequent to the closing year, *i e*, 9 11 36 The two items (*ii*) and (*iii*) will come into 1938 39 assessment In the assessment of 1937-38, will be included 31 12 35 and 15 3 36 receipts.

(B) New law (after amendment of 1939).

Items (*i*) (*ii*) and (*iii*) will be included in 1937 38 assessment as each source has a previous year and all are prior to 31 3 37.

Illustration 5.

If A has a business in Lucknow, one in Cawnpore and the third in Bareilly and if each business has a different accounting year, then, such of the years which satisfy the definition of previous year in section 2(11) with reference to the same year of assessment will be aggregated;

Lucknow, 30th April, 1940 (being the 1st year of business).

Bareilly, 28th February, 1940.

Cawnpore, 30th December, 1939.

For 1940-41 assessment, Bareilly and Cawnpore will be aggregated.

For 1941 42 assessment, Lucknow will be included in the aggregation.

NEW BUSINESS

(5) To put it in short, its previous year is either

(*a*) Setting up date to 31st March next, or

(*b*) Setting up date to any day accepted by custom which may be determined by the Central Board of Revenue, or

(*c*) Setting up date to any date on which accounts are made other than (*a*) and (*b*) provided such date does not fall beyond 31st March.

(*d*) nil (if the date contemplated in (*c*) above, is after 31st March

Illustration 6.

Thus if a business is set up on 15th May, 1939, and the accounts have been made on 31st December, 1939, then for the assessment year 1940 41, previous year shall, in strict interpretation of the law, be :-

(*a*) 15th May, 1939, to 31st March, 1940 (if the assessee does not declare any other date), or

(*b*) 15th May, 1939, to 31st December, 1939 (if the assessee chooses)

If the accounts are made at the end of a year to 14th May, 1940, then for the assessment year 1940 41, there will be no previous year and hence there will be no assessment for 1940-41 For 1941-42, the year ended 14th May, 1940, will be the previous year

When the assessee is a partner in a firm, the firm's previous year will be the partner's previous year.

Illustration 7.

A business is set up on 1. 11. 37 and it completes its year on 30. 10. 38. According to the present Act, without applying sec. 2(11)(b) its profits up to 30. 10. 38 can only be assessed for the assessment year 1939-40. But in Messrs Nanakchand Fatehchand's case, the Punjab High Court decided that a broken period up to 31st March next could have been assessed.

There is no doubt that under the very wide provision of sec. 2(11)(*b*) any year can be allowed by the Central Board but ordinarily this is not allowed. The new Law provides :—

(1) Once a particular period is brought under assessment, no further assessment on the same period is allowed (Previously double assessment could occur which is not possible now)

(2) If the previous year is to be changed, it can be done with the consent and conditions from the I T O.

(3) Where a business is newly set up then

(*a*) the 1st assessment will be up to 31st March next, or 1st assessment will be up to his closing day.

(*b*) if the closing day is not falling within the setting up day to 31st March next, then it is to be regarded that there is no previous year.

The application of the above will be as follows :—

BUSINESS SET UP ON 1. 11. 39.

(i) If the accounts are made up to March 31, (*i.e.*, 31. 3. 1940), then for 1940-41 assessment, profits from 1. 11. 39 to 31. 3. 40 will be included.

(*ii*) If the accounting year is declared to be 10th February (*i.e.*, 10. 2. 40), then 1940-41 assessment will include profits from 1. 11. 39 to 10. 2. 40.

(*iii*) If the accounting year is declared to be June 30 (*i.e.*, 30. 6. 40), then for 1940-41 assessment, there will be no previous year, according to the proviso of the new Act, and hence first assessment will be made in 1941-42 for the broken period from 1. 11. 39 to 30. 6. 40.

(6) Fiscal year- Income tax year begins on 1st April and ends on 31st March

(7) For the purpose of 1938-39 assessment, "previous year" will ordinarily be:

1st April, 1937, to 31st March, 1938, or

1st January, 1937, to 31st December, 1937

(Ordinarily, the last day of the previous year cannot go beyond one day previous to the first day of the assessment year, *i.e.*, 31st March, just previous to the assessment year).

(8) If an assessee closes his books on Ramnavami day or Akshoy Tritiya day or any other such date in every year, the dates will vary from year to year and the range of variation is wide, *e.g.*, Ramnavami may fall on any day between, say, 24th March to 19th April, Akshoy Tritiya may fall on any day between, say, 24th April to 16th May. In such cases only, the previous year will be allowed to overlap the assessment year, provided, of course, that the assessee had already declared to the Income tax Officer that his accounting year would usually end on Ramnavami day or Akshoy Tritiya day or on any such day accepted by custom, religious or otherwise.

While a margin of one month on either side of the accounting year has been allowed by the Act, the Central

Board of Revenue may authorise acceptance of any previous year.

This is also the practice provided declaration from the assessee had already been obtained as to closing the accounts on any such particular day

In the case Messrs Nanakchand Fatehchand *vs.* C.I.T., Punjab, 2. I.T.C. 167, the assessee firm commenced business on 18th April, 1923 The Income-tax Officer required the firm to furnish a return of its income during the previous year The firm instead of declaring its profits up to 31st March, 1924, for the assessment of 1924-25 submitted profits for full twelve months up to 17th April, 1924 The firm's contention was that it was not liable to tax as it was not in existence for a complete year before 1st April, 1924 The Income-tax authorities acting under 2 (11)(*b*) of the Act accepted as the accounting period from 18th April, 1923, to 17th April, 1924. It was decided that the previous year determined by the Commissioner was quite in order according to instructions of the Central Board of Revenue and the assessment was legal

(9) *Previous year refers to each source of income.* Each business unit is a source and therefore may have a previous year This will solve the difficulty experienced in Abu Baker's case

In Abu Baker Abdul Rahaman *v.* C.I.T., Bombay 1936 I.T.R.233, the assessee made up his accounts, including income from property, at Dewali on 9th November, 1931 He was a partner of the Movietone Company whose first year of existence ended on 31st December, 1931 In 1932-33 assessment, the assessee did not include his income from Movietone Company as the assessee's previous year ended on 9th November, 1931. Though the Movietone profits for the period to 31. 12. 31, would come ordinarily under 1932-33 assessment, still in this particular case, the previous year has been fixed to be 9th Nov., (Movietone profits can not be included as its year ended 31st December). But the I.T.O.,

included the profits from Movietone Company up to 31st December, 1931, and assessed him. It was decided by the High Court that as the assessee had to make a return of his total income up to 9th November, 1931, he could not be required to include his Movietone profits as that would mean adoption on the part of the assessee of two different previous years.

Illustration 8.

Suppose, a company started on 1. 7. 37.

			Rs.
1. 7. 37 to 30. 4. 38	=	Loss	7,000
1. 5. 38 to 31. 3. 39	=	Loss	6,000

1939-40 ASSESSMENT

I.T.O. computes as follows:

	Rs.	Rs.
Loss as per P & L a/c 1. 5. 38 to 31. 3. 39		= Loss 6,000
Written back inadmissible expenses	400	
,, ,, Depreciation	4,200	4,600
Loss for 11 months		1,400

Add one month of the previous P & L a/c which will be computed as follows:—

	Rs.	Rs.
Loss as per P & L a/c 1. 7. 37 to 30. 4. 38		Loss 7,000
Written back inadmissible expenses	600	
,, ,, Depreciation	4,800	5,400
Loss for 10 months		1,600

1/10 of Rs. 1,600 = Rs. 160.

Hence, loss carried forward to 1940-41 assessment is Rs. 1,400 + 160 = Rs. 1,560.

Depreciation claim of Rs. 4,200 having been eliminated from the above computation, it will be calculated separately on the scheduled rate, say, it comes to Rs. 4,000 which will be carried forward as unabsorbed depreciation for the assessment year 1940-41.

In such a case of computation of income for the year ending 31. 3. 39 for assessment year 1939-40, the assessee will raise a strong objection because he gets no consideration of his accounts for the period 1. 7. 37 to 30. 4. 38.

He loses

(*a*) in carry forward of loss,

(*b*) in carry forward of unabsorbed depreciation for he is entitled to two years' depreciation, which approximates to Rs. 7,500 (instead of his claim for Rs. 4,200 + 4,800 = Rs. 9,000).

The assessee ought to settle the question of assessment for the third reason, *viz.*, the computation of the written down value of the assets. This becomes essential for all future assessments for 1940-41.

In our opinion, (1) the I.T.O. would have done well to have included the first year's (up to 30. 4. 38) profits in 1939-40 assessment, or

(2) With the assessee's approval, first assessment in 1938-39 for the period 1. 7. 37 to 31. 3. 38 and in the next assessment in 1939-40, the full year's profits up to 31. 3. 39.

NOTE.—For appeal on this subject, see section 30.

Section 3. Where any Act of the Central Legislature enacts that income-tax shall be charged for any year at any rate or rates, tax at that rate or those rates shall be charged for

that year in accordance with, and subject to the provisions of, this Act in respect of the total income of the previous year of every individual, Hindu undivided family, company and local authority, and of every firm and other association of persons or the partners of the firm or members of the association individually.

NOTE —(A) It is charging section for Income Tax :—

(1) Who are taxed ?

(2) At what rate ?

(3) On what ?

Regarding (1)

This section charges the following to income tax :-

(*a*) Individual.

(*b*) Hindu undivided family

(*c*) Company.

(*d*) Local Authority.

(*e*) Firm (registered and unregistered).

(f) Other association of persons

Regarding (2)

The tax shall be charged at the rates applicable to the total income of the assessee in accordance with the provisions of the Finance Act in force for the year.

Regarding (3)

The tax shall be charged in respect of all incomes, profits and gains of the previous year.

(B) Note the word " other " in "other Association of persons." It suggests that some of the other items are also association of persons

(C) A company in liquidation is a 'company' within the meaning of section 3 of the Indian Income-tax Act and the income-tax authorities are entitled to call upon the liquidator of a company which is being wound up, to make a return in accordance with section 22(1) of the Act. (C.I.T., U.P., *vs* Official Liquidator of the Agra Spinning and Weaving Mills Co., Ltd., 1934, 2 I.T.R. 79.)

(D) The Amendment Act of 1939 has adopted "Slab System" in place of the "Step System" which was in vogue ever since Income Tax came to be introduced in India. The minimum limit of taxable income is the same (Rs. 2,000) as in the old system. The noteworthy feature provided by the Finance Act of 1939 in pursuance of the Amendment Act of 1939 introducing Slab System, is the exemption of the first slab of Rs. 1,500 from taxation. A fixed sum of Rs. 1,500 as exemption for every individual irrespective of his income of Rs. 4,000, 40,000 or 4 lacs does not seem to be very scientific. The Act in U. K. on the model of which the Indian Income Tax Act has been based, provides for an exemption of 1/5 of the earned income with a maximum of £300 for every individual apart from the many allowances and deductions which are conspicuous by their absence in the Indian Act. In the new Indian Act, the second slab and the subsequent slices have been subjected to tax at graded rates of tax. It will be seen that the advantage gained by the exemption is, to a large extent, nullified by the high rates and steeply graded ones. Still, it will be observed that the comparatively small incomes up to, say, Rs. 3,500 will now enjoy some relief; at the stage of Rs. 8,000, the old tax and the new tax come very near each other. Then again, there is some increase. The higher incomes up to Rs. 40,000 (roughly) however do not suffer much increase as will be seen from the table given below.—

The following table shows at a glance how much the individual has been paying under the old system and will pay under the new system :—

Income. per annum	OLD SCALE.		NEW SCALE	
	Tax	Percentage	Tax	Percentage.
2,000	1	...	...	...
2,150	73	3.4	30	1.4
2,500	85	3.4	47	1.9
2,700	91	3.4	56	2.0
3,000	102	3.4	70	2.3
3,250	110	3.4	82	2.5
3,500	118	3.4	94	2.7
3,750	127	3.4	106	2.8
4,000	135	3.4	118	3.0
4,500	152	3.4	141	3.1
5,000	170	3.4	164	3.3
5,333	271	5.1	190	3.6
5,700	289	5.1	219	3.8
6,000	305	5.1	242	4.0
6,667	339	5.1	294	4.4
8,000	406	5.1	398	5.0
9,000	457	5.1	477	5.3
10,000	509	5.1	555	5.6
10,600	718	6.8	630	6.0
12,000	813	6.8	805	6.7
13,500	914	6.8	992	7.3
15,000	1,017	6.8	1,180	7.9
16,700	1,508	9.0	1,415	8.7
20,000	1,806	9.0	1,961	9.8
21,000	2,251	10.7	2,117	10.1
25,000	2,680	10.7	2,742	11.0
26,500	2,841	10.7	3,070	11.6
30,000	3,217	10.7	3,836	12.8
33,000	4,434	13.5	4,492	13.6
35,000	4,796	13.7	4,930	14.1
40,000	5,700	14.2	6,336	15.8
44,000	6,919	15.7	7,461	17.0
45,000	7,109	15.8	7,742	17.2
50,000	8,069	16.1	9,148	18.3
55,000	9,197	16.7	10,555	19.2
60,000	10,325	17.2	12,274	20.5
65,000	11,454	17.6	13,993	21.5
67,000	11,905	17.8	14,680	21.9
70,000	12,582	18.0	15,712	22.4
74,000	13,485	18.2	17,087	23.1
75,000	13,710	18.3	17,430	23.2
80,000	14,840	18.6	19,149	23.9

The economics of *slab system and step system* may, however, be discussed here with advantage. With regard

to slab system, the main objection is that the ability of a person to pay does not depend on the first slice or any particular slice but wholly depends on the total income of any person. It is the total income alone which determines what financial burden a man can bear. This contention will be further strengthened when it is pointed out that the economic value of the first, second or any slice of a poor man is quite different from the value of the corresponding slices of a rich man; still the rate of tax imposed by the slab system is the same on both the rich man's slice and the poor man's slice. Marshall points out "the marginal utility of money is greater for the poor than the rich; . . . in other words, the richer a man becomes, the less is the marginal utility of money to him." To put this in more concrete form, the rich man has more slices to fall back upon than the poor or the man of moderate means and as the total number of slices in every case determines the relief to the ultimate burden of taxation, the number of slices or slabs is a determining factor to a man's ability to pay. Thus the same slab rates applicable to both the incomes of the rich and the poor cannot be a fair imposition.

It is, therefore, difficult to see much equity in the slab system. The equity lies in the progressive rates as between the different slices of the same man's income; but this must not be confused with the ability of one man when compared with that of the other. The step system, or, the "Total Income" basis has, in this particular respect, distinctly greater advantages. In these circumstances, the step system should have continued and could have been continued to yield the same results as are obtainable under the present new system. The defect of the Step system pointed out by the Committee is the hardship due to sudden jump from one rate to another. This could be easily rectified by introducing a more elaborate "marginal relief" scheme, by reducing the steepness of the old scale of rates and by creating more stages. The replace-

ment of the step system by an altogether new one will mean serious impairing of efficiency. The quickness and alertness due to experience gained by the department during the last twenty years will be ineffective, and the uninterrupted progress of Income Tax case-laws will considerably suffer.

As it was the genuine intention to reduce the burden of taxation to the large middle-class population in India, the attempt should not have been made by such a complicated slab system but by straightaway reducing the rates under the step system which due to its being simple, easy, equitable and equally scientific would have been more readily appreciated by a tax-payer.

(E) Bases of Indian and English Taxation Compared.

The basis of the *Indian* Taxation is -

(1) that an assessee is liable to pay to the Government income tax for any current year,

(2) on what accrued to him as income during the "previous year."

The basis of the *English* Taxation is—

(1) that an assessee is liable to pay to the Government income-tax for any current year,

(2) on the income of that very year,

(3) to be measured or computed by what accrued to him as income during the previous year.

The basis of Indian taxation as explained above raises a question, *viz.*—

If a source of income is absent in the year 1929-30 but existed in 1928-29, will the income be taxed in the assessment for 1929-30?

According to English law this income will not be included.

According to Indian law this income will be included.

Therefore it is clear that the existence or non-existence of the source of income in the year of assessment is immaterial. What is essential is the previous year's actual income; that income will be taxed. (C.I.T., U.P. *vs.* Tehri Garhwal Estate, 1934, I.T.R. 1; Behari Lal Mullick vs. C.I.T., Bengal, 1927, 2, I.T.C. 328).

INDIVIDUAL

(1) It is to be taxed in respect of his income from all sources belonging to him.

(2) Income tax on income exceeding Rs. 2,000.

(3) He gets exemption on average rate on his payments of premium to Life Insurance Company, and to provident funds the total being one sixth of his total income but the amount of exemption not exceeding Rs. 6,000.

(4) A Trustee, Administrator or Executor would be taxed as an individual subject to Section 41.

(5) A corporate body of trustee constituted by a special Act is an individual not an association of individuals. (Currimbhoy Ebrahim Baronetcy's case.)

(6) Whether he falls under one or the other category under Section 4A and 4B has to be ascertained every year.

(7) In England, husband and wife are assessed together, but in India, wife will be assessed separately on her own incomes, *viz.*, stridhan, etc. If husband has transferred any assets or income to his wife or minor child, this transferred income also will be included in husband's assessment (Section 16)

(8) He is liable to super tax over Rs 25,000.

Illustration 9.

From the following particulars find out the income-tax payable by A :—

(*a*) Profits from an unregistered Firm representing half share Rs. 900.

(*b*) Income from 4% War Bonds (Tax-free) ...Rs. 3,600.

(*c*) Dividends from A. Ltd. 7% (Tax-free) . Rs. 5,974.

(*d*) Income from 5% War Loan (Less Tax) ...Rs. 1,508.

(*e*) A wins a prize in a lottery Rs. 2,000.

(*f*) His life insurance premium amounts to annually. . .Rs.3,000.

Statement of Total Income

	Particulars	Gross Income			Tax deducted		
		Rs.	a.	p.	Rs.	a.	p.
1.	Unregistered Firm	*900	0	0			
2.	Income 4% War Bond (F/F)	3,600	0	0			
3.	Divs. A Ltd. 7% (F/F) (5974 × 16)	7,080	0	0	1,106	0	0
4.	Int. 5% War loan (L. T.) (1508 × 16)	1,787	4	0	279	4	0
	Total Income	13,367	4	0	1,385	4	0

Average rate @ 14.01 pies	Tax due					
Tax on Rs. 13,367 4 0 @ 14.01	975	9	0			
Less L. I. P. 2,227 14 0; „ Bond F. F. 3,600 0 0; 5,827-14-0 @ 14.01	425	4	0	550	5	0
				834	15	0
				(Refundable)		

HINDU UNDIVIDED FAMILY

(1) The essentials of Hindu Undivided Family may be said to consist in :—

(*i*) common nucleus of ancestral property,

* It has been assumed that direct assessment on the unregistered firm would yield less revenue than inclusion in the partner's separate assessments. Hence this treatment. In practice, the other partner's incomes, their individual average rates etc. are the various determining factors.

(*ii*) common fund,

(*iii*) common worship,

(*iv*) common food.

(2) Hindu undivided family is treated in the Act as a separate entity and taxed as such.

(3) "Where the incomes, profits and gains of a member of a H. U. F consists of his personal earnings and acquisitions by his own exertions, they must be treated as his self acquired property and not as a joint family property, unless they flow from the employment in business or otherwise of the joint funds" (I T M)

(4) All schools of Hindus will come under H U. F.

(5) To pay income tax like an individual, *i.e.*, over Rs 2,000

(6) Portions of Hindu Undivided Family incomes received by individual members are not to be included in the total income at the time when individual members are separately assessed either to income tax or super tax.

(7) Even if the Hindu Undivided Family income is below Rs 2,000 (*i.e.*, when it is not taxed as Hindu Undivided Family income at the hands of the manager of the family) the portions distributed (as mentioned in paragraph above) are not to be taken into account in the separate assessments

(8) Super tax exemption is Rs 25,000

(9) Paragraphs 6 and 7 above apply to super-tax also.

(10) Allowances paid to a member of the family are a part of the income of the head of the family

(11) Hindu Undivided Family cannot be registered as a firm.

(12) Joint family members may separate but still may continue to carry on business jointly as before in which case they will either be taxed as a firm or as an Association of persons but not as H. U F.

In Maharaja Visweswar Singh *vs.* C.I.T., Bihar (April 1935) I.T.R. 216, the Maharaja of Darbhanga, the holder of impartible Raj and the elder brother of the assessee, by an agreement made a 'babuana' grant to the assessee consisting of a number of villages in consideration of the assessee giving up all claims to the properties of the assessee's father. In addition to the above grant, the Maharaja of Darbhanga gave him an allowance of Rs. 48,000 annually. It was decided that this allowance was not liable to tax under section 14(1) as the allowance was received " as a member of the Hindu Undivided Family."

In C I T., U P. *vs.* Vizianagram Maharaj Kumar (January 1935), 3, I.T R 155, the question arose in the Allahabad High Court as to whether the allowance of Rs 10,000 per month received by the younger brother of the Maharaja of Vizianagram who holds an impartible Raj, could be assessed to tax. The assessee claimed under section 14(1) that this income was exempt as it was received "as a member of the Hindu undivided family " The High Court came to the conclusion that the allowance received by the assessee came under section 14(1), but referred the matter to the Privy Council for authoritative pronouncement under section 66A, sub-section (2)

In the case of Kalyanji Vithaldas *vs.* C I T , Bengal, 1937, I.T R 90, the Privy Council observed that in the case of a H U F governed by Mitakshara System, the ancestral property may remain joint family property or may vest, under certain circumstances, in the individual who has got the property by survivorship as the sole surviving member The judgment of Sir George Rankin runs as follows :—

" There remains the case of Kanji and Sewdas Neither has a son but, in the case of each, his interest in the firm was obtained by gift from his father Moolji. Without deciding the question which was left open in Lal Ram Singh *vs.* Deputy Commissioner (50 I A. 265), their Lordships, for the purpose of the present case, will assume that their interest was ancestral property, so that, if either had had a son, the son would have taken an interest therein by birth. But no son having been born, no such interest has arisen to qualify or diminish the interest given by Moolji to Kanji and to Sewdas. Does then the existence of a wife, or of a wife

and a daughter, make it income of a Hindu undivided family rather than income of the individual partner? Their Lordships think not. A man's wife and daughter are entitled to be maintained by him out of separate property as well as out of property in which he has a coparcenary interest, but the mere existence of a wife or daughter does not make ancestral property joint. "Interest" is a word of wide and vague significance, and no doubt it might be used of a wife's or daughter's right to be maintained, which right accrues in the daughter's case on birth; but if the father's obligations are increased, his ownership is not divested, divided or impaired by marriage or the birth of a daughter This is equally true of ancestral property belonging to himself alone as of self-acquired property . . By reason of its origin a man's property may be liable to be divested wholly or in part on the happening of a particular event, or may be answerable for particular obligations, or may pass at his death in a particular way; but if, in spite of all such facts, his personal law regards him as the owner, the property as his property and the income therefrom as his income, it is chargeable to income-tax as his, *i.e.* as the income of an individual In their Lordships' view, it would not be in consonance with ordinary notions or with a correct interpretation of the law of the Mitakshara, to hold that property which a man has obtained from his father belongs to a Hindu undivided family by reason of his having a wife and daughters."

In Moolji Sicka and others *vs* C I T., Bengal (1935), it was decided that Hindu undivided family meant a Hindu coparcenary for the purposes of the Income-tax Act Justice Lort Williams observed "The necessity for making Hindu undivided family liable as such for income-tax was that the income and property of Hindu undivided family is undivided The members have no separate income or property and cannot, therefore, be taxed as individuals According to Mitakshara, until partition it cannot be said of any member that he has any definite share in the joint property. But Income-tax Act obviously is concerned only with income available for taxation and the owner of such income, and if there is no property or no income, an Income-tax Act has no application. It follows that the Act has no application to a Hindu Undivided Family in the wider sense to which I have referred. Its provisions are attracted only where there exists property or income, that is to say, where there is a joint family property or joint family income or, in other words, where there exists a Hindu

coparcenary. . . If it were otherwise, a most absurd and unanticipated position would arise. Every Hindu possessing property or income who married would, ipso facto, become with his wife a Hindu Undivided Family and subject to taxation as such. The Income-tax Act, so far as Hindus are concerned as individuals, would apply only to bachelors. This cannot have been intended. In my opinion, therefore, where in the section of the Income-tax Act a Hindu Undivided Family is mentioned a Hindu coparcenary is meant."

From Moolji Sicka's case (1935, I.T.R. 123) two points emerge :-

(1) H. U. F is a 'Hindu coparcenary' and therefore one male and other women members for maintenance would form a H U. F

(2) Self-acquired property cannot be thrown into common stock and cannot claim to be assessed as H. U. F.

In the appeal (1937, I T.R 70), the Privy Council did not agree to give the above narrow meaning (Hindu coparcenary) to H U. F

In Gomedalli Lakshminarayan *vs* C I T, Bombay (1935), which came up a little later, the Bombay High Court held that the Hindu Undivided Family has been used in the Act in a wider sense (not coparcenary) Therefore even in the absence of any other male member, the family would be regarded as Hindu Undivided Family for Income-tax purposes In this case the Hindu Undivided Family consisted of the assessee, his father, mother and wife. On the death of the father, the family consisted of the other three. The question was as to whether the sole surviving male member would be taxed as an individual or as Hindu Undivided Family.

The High Court decided that it was a Hindu Undivided Family consisting of a sole male member and female member entitled to maintenance

From the judgment of the appeal (1937, I.T.R. 416) before the Privy Council in Gomedalli Lakshminarayan's case, the following points emerge :—

(1) **Does the income belong to H. U. F. or to the surviving member?**

(2) When a member obtains property from his father, it is not necessarily the property of the H. U. F. merely on the ground that he constitutes a H. U. F. with his wife and children. The question is who is the owner of the property. The decision of the Privy Council definitely states that in such cases, it is the income of the individuals.

THE HINDU GAINS OF LEARNING ACT of 1930 provides the following :-

Notwithstanding any custom, rule or interpretation of the Hindu Law, no gains of learning shall be held not to be the exclusive and separate property of the acquirer merely by reason of-

(*a*) his learning having been, in whole or in part, imparted to him by any member, living or deceased, of his family, or with the aid of the joint funds of his family, or with the aid of the funds of any member thereof, or

(*b*) himself or his family having, while he was acquiring his learning, been maintained or supported, wholly or in part, by the joint funds of his family, or by the funds of any member thereof

Stridhan :--

Properties owned absolutely by Female members of Hindu Families are called Stridhan.

Such properties have the following characteristics :—

(*i*) The female has the complete control both over the corpus and the income.

(*ii*) Therefore she can alienate the property without any restriction.

(*iii*) Such properties are ordinarily obtained by gifts or presents from her husband or his relations or from her father or her other relations.

These incomes not being Joint Family incomes (and being separate incomes) cannot be taxed in the Joint Family income. As the Income-tax law stands at present, females are taxed separately as individuals in respect of Stridhan.

A female is assessed separately on the following incomes ordinarily :—

(*i*) Stridhan,

(*ii*) Hindu Woman's Estate :—

(*a*) Estate which she inherits either from her husband or from any other relation.

(*b*) She has complete control over the usufruct of such a property during her lifetime

(*c*) But her right to the corpus of the property is restricted to the extent that she cannot make a testamentary gift of it or alienate it except under certain circumstances which technically constitute "legal necessity."

(*iii*) Annuity.

Until recently, the law was that a female was taxed as a separate individual in respect of all her incomes and therefore incomes from Stridhan, Hindu woman's property and annuities were taxed separately in her hands, together with income from assets transferred by husband.

But as the law stands just at present by the addition of an amendment to Section 16 of the Act, the incomes from "assets transferred . . . apart" have got to be included in the total income of husband and be assessed to tax.

The wife thus will be assessed separately only with respect to Stridhan, Hindu woman's estate and annuity and such other properties which are her own except those which come under 'transference' under Section 16, even though the transference be absolute gifts to the wife. While Hindu assessee will come under the mischief of this law, as there is no adequate consideration, a Muslim husband escapes the aggregation on the ground that transference which in this case, is 'for adequate consideration', is by way of payment of dower debt.

IMPARTIBLE ESTATE

(1) Estate that cannot be legally partitioned.

(2) "That except in Madras no coparcener can restrain alienations by the head of the family though the right to maintenance and of survivorship may exist" (Raja of Bobbili *vs.* C I T., Madras, 1937, I.T R., 83).

(3) Impartible property whether coparcenary property :--

In considering whether an ancestral impartible estate is coparcenary property or not, a distinction should be drawn between present rights, that is, the right to demand a partition and the right to joint enjoyment, and future rights In the case of an impartible estate the right to partition and the right of joint enjoyment are from the very nature of the property incapable of existence, and there is no coparcenary to this extent. No coparcener, therefore, can prevent alienations of the estate by the holder for the time being either by gift or by will (Section 588), nor is he entitled to maintenance out of the estate (Section 589). But as regards future rights, that is, the right to survivorship, the property is to be treated as coparcenary property, so that on the death intestate of the last holder, it will devolve by survivorship according to the rules stated in Section 591 . . . (Mulla's Hindu Law.)

(4) Maintenance allowance received by junior members of an impartible Raj would be exempt under Section

14(1). (In Re Maharaj Kumar of Vizianagram, 1934, 2, I.T.R., 186).

(5) Governed by rules of primogeniture.

(6) Its income *belongs to the Joint Hindu Family* and is assessable as such.

(*a*) It is still a joint family and the holder of such an estate will be assessed as the Head of Hindu Undivided Family and not as an individual. (Kishen Kishore *vs.* C.I.T., Punjab, 1933, I.T.R., 143.)

(*b*) Allowances payable to junior members are an allowable deduction in calculating the assessable income of the head of the family. (Kishen Kishore *vs* C.I.T., Punjab, 1933, I.T.R., 143)

(*c*) In the recent case of C.I.T., Lahore, *vs.* Dewan Krishan Kishore, 1939, I.T.R., 427, Justice Dalip Singh referred to the ruling of the Privy Council in the case of Kalyanji Vitaldas (1937, I.T.R. 90) and observed in this connection:

"A female might be a member of H. U. F. though she might not be a member of the Hindu coparcenary and the question there being discussed by their Lordships was whether the existence of a wife or a wife and a daughter could be held to make the income which went to the sole male member of the family the income of a H. U. F. and it was with reference to this question that their Lordships' remarks must be read. That matter it appears to me is perfectly distinct from the question whether, where admittedly a Hindu coparcenary is existing, the income arising from the corpus of property owned by that coparcenary can be said to be the absolute income of the head of the family."

Held "The income of an impartible estate to which the assessee has succeeded by the rule of primogeniture prevailing in his family which is governed by the Mitakshara law is not chargeable to income-tax in his hands as that of an 'individual'."

(7) Its income is the *sole property of the holder* for the time being and hence assessable as individual :—

(*a*) In Raja Shiv Prasad Singh (1924, 1, I.T.C. 384), it was held that the Finance Act contemplated larger deduction for Super-tax in a case where income is that of a H. U. F. only in which they are all jointly interested and not in the case of an impartible estate where income is the sole property of the holder for the time being and therefore the larger exemption claimed (the assessee was assessed to Super tax as individual) could not be allowed.

(*b*) Impartibility is essentially a creation of custom. In the case of ordinary joint family property, the members of the family have

(1) the right of partition

(2) the right to restrain alienations by the head of the family except for necessity

(3) the right of maintenance and

(4) the right of survivorship.

The first of these rights cannot exist in the case of an impartible estate, though ancestral, from the very nature of the estate. The second is incompatible with the custom of impartibility as laid down in Sartaj Kuari's case (I L R. 10, All. 272) and the first Pittapur case (I L R 22, Mad. 383) and so also the third as held in the second Pittapur case (I L R. 47, Mad. 778). To this extent the general law of the Mitakshara has been superseded by custom, and the impartible estate, though ancestral, is clothed with the incidents of self-acquired and separate property. But the right of survivorship is not inconsistent with the custom of impartibility. This right, therefore, still remains, and this is what was held in Baijnath's case (I L.R. 43, All. 228). To this extent the estate still retains its character of joint family property, and its devolution is governed by the general Mitakshara law applicable to such property. (Raja of Bobbili *vs.* C.I.T., Madras, 1937, I.T.R. 83.)

JOINT-STOCK COMPANY

(1) To pay income-tax at the highest rate (30 pies) on the whole of its statutory profits whatever be the amount of profits.

(2) A Joint-stock Company's dividends are not taxed again (only included in the personal assessment for rate purposes) in the hands of the shareholders.

(3) To pay super-tax at the flat rate of one anna on every rupee. Even when the company pays Super-Tax, Super-Tax at graded rate will be levied individually on the assessee's total incomes which will include gross dividends also. There is now no free slab. This shows that Super Tax on Companies is really corporation tax.

(4) A Company is resident if the control and management of its affairs is situated wholly in British India that year (Previous year) or its income arising in British India exceeds its income outside British India in that year (Sec. 4A(c)).

Illustration 10.

The Profit and Loss Account of A. B. Co., Ltd., is as follows :—

	Rs.		Rs.
Salaries	33,000	Gross Profit	1,45,000
Rent	5,500	Sundry receipts	5,750
Trade Expenses	13,500	Rent from sub-letting	500
Debenture Interest	6,000	Premium on shares	1,500
Preliminary Expenses	7,500	Govt. subsidy for development of the Company's industry	8,000
Loss on sale of investments	3,500	Dividends (Gross)	20,000
Income-tax (previous years' final adjustment)	4,000		
Depreciation—			
Plant 10%	7,500		
Furniture 5%	250		
Net Profit	1,00,000		
	1,80,750		1,80,750

Ascertain Income-tax and Super-tax payable (if any). The claim for depreciation is fully allowed.

Solution

Profit and Loss Adjustment Account.

	Rs.		Rs.
To premium on shares	1,500	By Net Profit	1,00,000
„ Govt. Subsidy	8,000	„ Preliminary Expense ..	7,500
„ Dividends ..	20,000	„ Loss on sale of investments	3,500
„ Adjusted Profits	85,500	„ Income-tax	4,000
	1,15,000		1,15,000

NOTE – For the sake of illustration, dividends have been shown in gross figure. In actual practice, Dividends could not have been received gross—Tax was deducted. But gross dividends have been put in the P. & L. A/c to illustrate that even if gross figure is found in the P. & L. A/c, an item of another source should be written back.

Income-Tax.

Business Income	Rs.	85,500
Add gross income from investments	Rs.	20,000
	Rs	1,05,500 Total Income.
Tax at 30 pies on Rs. 1,05,500	=Rs.	16,484 6 0
Less tax paid on Dividends	=Rs.	3,125 0 0
Tax to be paid	=Rs.	13,359 6 0

Super-Tax

Total Income Rs. 1,05,500 at -/1/- = Rs. 6,593 12 0

Meaning of " Free of Tax " and " Less Tax" :—

'*Free of Tax*' in the case of Government bonds and Securities means that the securities are actually free from tax.

'*Free of Tax*' in the case of private securities (*viz.*, Limited Companies). means that the securities are not actually free from tax but that the shareholders have not to

pay tax again from their own other funds and that the Company had already paid tax from its undivided profits on behalf of the shareholders.

"*Less Tax*" in the case of Government Securities and also in the case of private securities and investments means one and the same thing, *viz.*, that they have to bear tax. Only the net amount is handed over to the security holders.

From the investor's point of view securities issued income tax free whether by the Government of India or by Local Government mean the same thing.

Illustration 11

(1) Rs. 500 Alpha Trading, Ltd., at 7% (Less Tax) means Rs. 35 (gross) on which Rs. 5 7 6 (Income-tax at 30 pies) deducted. Hence, Rs. 29 8 6 actually received.

(2) Rs. 500 War Loan at 7% (Less Tax) means as above.

(3) Rs. 500 War Loan at 7%. (Free of Tax) means Rs. 35 gross or net.

(4) Rs. 500 Alpha Trading, Ltd., at 7% (Free of Tax) means Rs. 35 net
means Rs. 41 8 0 (35 + [illegible]) gross

(5) Dividend 4% (Free of Tax) on Rs. 8,100 in A.B., Ltd., means Rs. 324 net
,, 384 (324 + [illegible]) gross
,, $4\frac{20}{27}$% (Less Tax).

Illustration 12.

A company in a particular year makes profits (agreed to by the I.T.O.) of Rs. 40,000. It is resolved to distribute it as follows:—

5% Preference shares (on Rs. 400,000)	**= Rs. 20,000**
Ordinary shares at 7% (on Rs. 200,000)	**= Rs. 14,000**
Balance carried to reserve	**= Rs. 6,000**
	Rs. 40,000

If the above dividends Rs. 34,000 are to be declared "Free of Tax" then the company will have to bear tax on the whole of Rs. 40,000 (30 pies rate). The whole Rs. 34,000 will go to the shareholders and tax on Rs. 40,000 will be paid to the Income-tax authorities out of the undivided profits of the company.

If the above dividends are declared 'Less Tax,' then the company will firstly pay tax at 30 pies rate on Rs. 40,000 but later will recoup tax on Rs. 34,000 from the shareholders. The balance of tax will have to be borne by the company, *i.e.*, the tax on Rs. 6,000 will not be recouped

REGISTERED FIRM

(1) Firm not to pay Income-tax as such. Only profit or loss to be determined and allocated to the partners under Section 23(5)(*a*)

(2) Every partner has to include his portion of the Registered Firm's profits into his total Income and be directly assessed.

(3) Question of refund or avoidance of double assessment does not arise.

(4) Not to pay super-tax as such but individual partners are to pay in their separate assessments (their respective shares from the firm profits being included in their total incomes).

(5) It is resident, if the control and management of its affairs is not wholly situated outside British India 4A(b).

(6) If a partner is non-resident the tax is to be recovered from the firm.

Illustration 13.

A and B are equal partners in a registered firm whose assessable net profit amounts to Rs. 48,860. A has in-

vested Rs. 15,000 in 7% Calcutta Port Trust Bonds and Rs. 20,000 in 5½% (Tax-free) War Loan. A is a retired Government Engineer and gets a pension of Rs. 560 per month. He also received Rs. 300 as Director's fees and B received Rs. 170 as Director's fees.

B owns 3 shops the annual letting value of which amounts to Rs. 360 each.

State what amount of Income-tax and Super-tax each partner will have to pay.

	A				B	
	Gross Income.	Tax deducted			Gross Income	Tax deducted.
	Rs	Rs.	a.	p.	Rs.	Rs
(1) Share of Registered Firm	24,430				24,430	
(2) 7 % Port Trust Bonds Rs 15,000	1,050	164	2	0		
(3) 5½ % (Tax-free) War Loan for Rs 20,000	1,100					
(4) Pension Rs 560 p m	6,720	298	7	0		
(5) Director's Fees	300				170	
(6) Shop annual value Rs 1,080 Less repairs 180 900					900	
Total Income	33,600	462	9	0	25,500	nil.

Solution. *A's Income-Tax.*

Total Income Rs 33,600 at 23·34 pies	Tax Rs	4,084	8	0
Less F. T Income Rs. 1,100 at 23·34 pies	Rs.	133	11	6
	Rs.	3,950	12	6
Less already paid	Rs.	462	9	0
Still to pay	Rs	3,488	3	6

A's Super-Tax

1st Rs. 25,000		Nil.		
Next Rs. 8,600 at -/1/-	Rs	537	8	0
Rs. 33,600	Rs.	537	8	0

B's Income-Tax.

Total Income Rs. 25,500 at 21·23 pies (average rate)

Tax Rs. 2,820 5 0

B's Super-Tax

1st Rs. 25,000	...	...	Nil.
Next Rs. 500 at -/1/-	...	...	Rs. 31 4 0
Rs. 25,500			Rs. 31 4 0

UNREGISTERED FIRM

(1) To pay income-tax like an individual.

(2) If the firm is assessed directly then

(*a*) Each partner's share is to be included in his total income irrespective of the firm showing profits over or below Rs. 2,000.

(*b*) But that particular share is not to be taxed again in the hands of the partners if the firm profits exceed Rs. 2,000 and has been taxed in the hands of the Firm.

(3) But if the firm is not assessed directly, then, the procedure will be like the registered firm above. (An unregistered firm may under Section 23(5)(*b*) be assessed as a registered firm if, in the Income-tax Officer's opinion, the aggregate amount of tax including super-tax, payable by the partners under such procedure be greater than the aggregate amount which would be payable by the firm and the partners individually if the firm were assessed directly as an unregistered firm).

(4) Now that the Income-tax Officer has the right to choose, there cannot be a case of refund in favour of the assessee.

(5) If the firm is not directly taxed—its profits being less than Rs. 2,000, then every individual partner must include his own share in his separate Total Income to de-

termine the rate and to pay tax on that portion according to the rate determined by his Total Income.

(6) To pay Super-tax like an individual on that amount which is in excess of Rs. 25,000. (Only exception being Section 23(5)(*b*)).

(7) If the Firm as such pays S.T., the individual partner is not to pay again on the same share but the individual's share is to be included in his Total Income for S.T. purposes to determine the rate.

(8) But if the Firm as such is not super-taxed, then, the income which any individual member of an unregistered Firm receives from the Firm is included in his Total Income and charged to Super-Tax

Illustration 14

A and B carry on a business as an unregistered firm They share equally. Their Profit and Loss Account for 1925 is as follows :-

	Rs.	Rs.		Rs.
To Rent		150	By Gross Profit	7,500
To Rates, etc.		40	By Bad Debts recovered	70
To Salaries, A	300			
To Salaries, B	500			
		800		
To Salaries to Office Staff		300		
To Interest on Capital, A	160	...		
To Interest on Capital, B	190			
		350		
To Bad Debts Reserve		125		
To Depreciation of Machinery and Furniture at 7%		140		
To Net Profit		5,665		
		7,570		7,570

Depreciation at 5% allowed by I.T.O.

B has an income from the following :—

	Rs.
(1) Dividends from A.B.C. Co., Ltd., 9% (less tax) ..	3,400
(2) Fees as Director	1,800
(3) Interest from 5% War Bond (Tax-free) ...	3,200
(4) Dividends from X.Y. Co., Ltd., 6% (Tax-free) ...	2,987
(5) Profits (agreed to by I.T.O.) from a registered Firm representing one-third share	400

Find out from the above the income-tax payable by B.

Solution.

Profit and Loss Adjustment A/c.

	Rs.		Rs.	Rs.
To assessable Profit	6,980	By Net Profit		5,665
		By Salaries A	300	
		By Salaries B	500	
				800
		By Interest on Capital A	160	
		Capital B	190	
				350
		By Bad Debts Reserve		125
		By Depreciation 2%		40
	6,980			6,980

Equitable Adjustment between the partners :—

Firm Income	...	Rs. 6,980
Less salaries	Rs. 800	
Less Int. on Capital	Rs. 350	
		Rs. 1,150
		Rs. 5,830

	Salary.	Interest	Firm	Total
A	300	160	2,915	3,375
B	500	190	2,915	3,605

B's income.		Gross.			Tax deducted.		
	Rs.	Rs.	a.	p.	Rs.	a.	p.
(1) A. B Co, Ltd 9% (less tax)	3,100	4,029	10	0	620	10	0
(2) Director's fees . . .	1,800	1,800	0	0	...		
(3) 5% War Bond (tax-free) .	3,200	3,200	0	0	...		
(4) X. Y., Ltd, 6% (tax-free) .	2 987	3,540	0	0	553	0	0
(5) Registered firm 1/3 share	400	400	0	0	..		
*(6) Unregistered firm	3,605	3,605	0	0			
Total Income		16,574	10	0	1,182	10	0

Before assessment is made either on firm or on individuals separately, the respective revenue yields have got to be ascertained :

A's income is Rs 3,375 and the rate is 5 pies; tax Rs. 87 14 0.

B's income is Rs 16,575 and the rate is 16 52 Tax on Rs 3,605 is Rs 310 3 0

Hence, the result of the separate assessments will be more favourable to I T.O , hence, separate assessment :-

B's Assessment.

Total Income Rs. 16,575 at the average rate 16 52	Rs 1,425 13 0
Less F, T Income Rs 3,200 at 16 52	Rs 275 5 8
	Rs 1,150 7 4 due
Less already paid	Rs 1,182 10 0
	Rs. 32 2 8 refundable.

A's Assessment.

Rs. 3,375 at 5 pies Rs. 87 14 0

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* NOTE.—The unregistered firm, if directly taxed, will have paid Rs. 318-12-0 at (8 77 pies)

of which A has to bear [illegible] × Rs. 318-12-0 . Rs. 154-2-0
B ,, ,, ,, [illegible] × Rs. 318-12-0 = Rs. 164-10-0.

Illustration 15.

In the previous illustration, if A has no other income

and if B has bank interest	Rs. 395	0	0
and Director's fees	Rs. 160	0	0

Then A's total income Rs. 3,375; tax is Rs. 87 14 0

B's total income Rs. 4,160

average rate is 5·75;

Tax on Rs. 3,605 at 5·75 pies is	Rs. 108	0	5
Total tax on A and B	=Rs. 195	14	5

This indirect or separate assessment yields, on account of the firm, a revenue of Rs. 195 14 5, whereas the direct assessment on the firm yields a revenue of Rs. 318-12-0.

Therefore direct assessment will be done.

The liability of the partners will be as follows:—

A	Rs.	a.	p.	B	Rs	a	p.
(1) Firm is taxed and his share of income is ..	3,375	0	0	(1) Firm is taxed and his share of income is .	3,605	0	0
(2) Tax in his share	174	2	0	(2) Tax in his share	164	10	0
(3) No demand separately as individual				(3) Bank interest Rs. 395 Director's fees Rs. 160	555	0	0
				Tax at 5·75 pies on Rs 555 is ...	16	9	8
				Hence demand of the amount Rs 16 9 8 to be made separately as individual.			

Association of Persons

(1) 'Person' includes

(*a*) Individuals,

(*b*) Hindu undivided family,

(*c*) Firm (Registered or unregistered),

(*d*) Body of individuals,

(*e*) Local authority,

(*f*) Company.

(2) It is not very clear as to whether an Association of persons should be taxed as an individual or as Company or as an unregistered firm. (There is no doubt that it is treated more like an unregistered firm.) But from the fact that separate provision has been made, *viz.*, Section 9(3), regarding Association of persons where shares are determinate and from the official instruction given below:

"For the year commencing on 1st April, 1940, the maximum amount which is not chargeable to income-tax is as follows:—

In the case of—

	Rs.
(*i*) Any Court of Wards, Administrator General, Official Trustee, any Receiver or Manager appointed under any order of a Court, or any trustee or trustees appointed under a duly executed trust deed, where the income, profits or gains or any part thereof are not specifically receivable on behalf of any one person, or where the individual shares of the persons on whose behalf they are receivable are indeterminate or unknown	Nil
(*ii*) Any company or local authority	Nil.
(*iii*) Any person, being a British subject or the subject of a state in India or Burma, who is not resident in British India and whose total world income exceeds Rs. 2,000	Nil
(*iv*) Any other non-resident person ...	Nil.
(*v*) Any other individual, Hindu Undivided Family, firm or association of persons	2,000"

It will follow by implications and inferences (not on the strength of any Section of the Act) that Association of persons will fall under the groupings as given above and therefore they will be treated and assessed accordingly.

(3) If the total income is below Rs. 2,000 or if the shares of the persons are definite and ascertainable then each one's share of the profits or income will be included

in each one's separate assessment and will be taxed at the rate determined by the total income.

(4) (*a*) If the association has been assessed as such then also each one's share of the profits or income will be included in each one's separate assessment for the purpose of determining the liability and rate

(*b*) But this share of profits or income received from the association will not be taxed again [under Sec. 14(2)(*b*)].

(5) To pay Super-tax :—

(*a*) In the case of company and local authority at one anna on every rupee.

(*b*) Individuals, Hindu Undivided Family,

Unregistered firm and other association of persons :—

First 25,000	Nil.
Next 10 000	1 anna.
Etc	Etc.

"Provided further that, where the profits and gains of an unregistered firm or other association of persons not being a company have been assessed to super-tax, super-tax shall not be payable by a partner of the firm or a member of the association, as the case may be, in respect of the amount of such profits and gains which is proportionate to his share "

In Chambers of Commerce, Hapur *vs* C I T., U P. 9, I.T.C. 393 (1936), the Chamber being registered as a company under section 26 of the Companies Act (*i.e.*, association not formed for earning profits) claimed to be exempted from income-tax. The High Court decided against this claim

In C.I.T Bombay *vs*. Karachi Chamber of Commerce, 1939, I.T.R. 575, the Karachi Chamber of Commerce was an association of business men registered under Section 26 of the Indian Companies Act, and its object as set out in its memorandum of association was to encour ge the trade, commerce and manufactures of India and the interest of persons engaged therein, and particularly to advance and protect the business interests of its own members.

No bonus was to be paid and on dissolution its property was to go to other similar institutions. The association employed a 'Public Measure' to measure the merchandise of members and outsiders, the freight on which was payable on measurement, and received a substantial amount by way of measurement fees. Subscriptions from the members were exempted from income-tax, but the whole amount of measurement fees including sums received from the members, was taxed: *Held*, that the measurement charges realised from its members were not taxable income.

Held, the fact that the services rendered by the Chamber to its members related to business or trade is immaterial. The test in such cases is not the purpose of the association but its nature. If its services are solely for the benefit of the members, or, if not solely for the benefit of its members, if the services for its members and the cost thereof are clearly separable from its services to non-members and the cost thereof, then there is no profit, but merely a surplus or saving.

In B. N. Elias and others *vs* C. I. T., Bengal 1935, 40 C. W. N. 476, a certain house property was bought by four individuals and they were joint owners holding the property as tenants in common. The Income-tax Officer assessed them as an association of individuals. The individuals contended that they should be taxed as co-owners, *i.e.*, individual assessments should have been made on the owners of the property separately. The High Court decided that it was an association of individuals.

The above decision has been made completely ineffective by the introduction of the new sub-section 3 under section 9 which runs as follows: -

Where property is owned by two or more persons and their respective shares are definite and ascertainable, such persons shall not in respect of such property be assessed as an association of persons, but the share of each such person in the income from the property as computed in accordance with this section shall be included in his total income.

In Currimbhoy Ebrahim Baronetcy Trust *vs* C.I.T. Bombay (1932, 5, I.T.C. 484), the Chief Justice of the Bombay High Court held that the Corporation (*i.e.*, the Trust) was an 'individual' within the meaning of the section and not an "association of individuals".

In C.I.T. Bombay vs. Ahmedabad Millowners' Association (1939, I.T.R. 369) it was held that the expression 'association of individuals' in sec. 3 meant an association of human beings.

In Lucknow Ice Association vs. C.I.T., U.P. (1926, 2, I.T,C, 156), several ice manufacturing firms formed a selling association for preventing underselling. It was decided that the association was a separate firm and was to be assessed.

In Mian Channu Factories Union vs. C.I.T. Punjab (1936, I.T.R. 203), it was decided that the two firms and a H.U.F. constituting the above Ginning Factories Union would be assessed as "association of individuals".

Social Club.

The income of a social club is not liable to be taxed except in so far as it deals with outsiders and makes profits. The members in such cases pay themselves certain sums of money for certain pastimes, amenities and conveniences and if they overcharge themselves the surplus which is applied to providing conveniences cannot be called profit as the members cannot trade with themselves and make profit.

In the Royal Calcutta Turf Club vs. Secretary of State, 1, I.T.C. 108, it was decided that

(1) entrance fee to the stand paddocks and gate money,

(2) entrance fee paid by owners of horses,

(3) book makers' licence fee,

(4) percentage of totalisation,

were taxable.

C.I.T., Madras, vs. Madras Cricket Club, 1934, I.T.R., 209, it took lease of a land from Government and erected a building. Though the club contended that they were not the owners of the land still it was held that the assessee was taxable as owner under section 9 of the Act.

Income or Capital

In the Imperial Chemical Industries (India), Ltd., 1935, I.T.R. 21, the Company claimed an expenditure (being a payment by the assessee of a lump sum to his agent on the termination of

agency) admissible under section 10(2) and the Income-tax authorities did not allow this. The High Court did not agree with the Income-tax authorities and allowed it a deduction from assessee's profits.

In the Anglo-Persian Oil Company (India), Ltd., 6 I.T.C. 419, the Calcutta High Court held that money paid in a lump sum as compensation for loss of agency whereby the Company relieved itself of future annual payments of commission chargeable to revenue account can be allowed as a proper deduction under section 10(2).

In Shaw Wallace's case, 6, I.T.C. 178, it was acting as distributing agent for two oil companies. They terminated the agency and gave compensation. The Judicial Committee held that these sums were not received from carrying on business but from the compulsory termination of agency.

The Amendment Act of 1939 nullifies this decision. There can be no doubt that the position so far created by the Shaw Wallace's case, Anglo Persian Oil Company's case, Imperial Chemical Industries case is

(1) the expenditure incurred by the payer is allowed as a deduction in the P & L. A/c as revenue debit (Imperial Chemical and Anglo-Persian cases);

(2) the corresponding receipt is exempt in the hands of the recipient as capital receipt (Shaw Wallace's case.)

This position cannot be defended except under special circumstances. The Amendment is therefore appropriate.

In Raja Bijai Singh Dudhuria *vs.* C.I.T., Bengal, 1933, I.T.R. 135, the Raja had to pay under a court decree a monthly sum to his step mother. The whole zamindari property was charged in the hands of the mother. It was held that as there is a specific charge and as the income is diverted beyond the reach of the assessee, it is not income of the assessee.

In the English case, *viz.*, Van Den Bergh's case, 1935, I.T.R. 17, X and Y were rivals in a trade—they entered into an agreement

and later, Y terminated the agreement and paid X a compensation.

The Commissioner decided it as income.

The High Court decided it as capital.

The Court of Appeal decided it as income.

The House of Lords decided it as capital.

In Commissioner of Income-tax, Bengal, *vs.* Mercantile Bank of India and others, 1936, I.T.R. 237, before the Privy Council the following case was stated :—

" The late Sir David Yule died on July 3, 1928, leaving a very large estate, which mainly consisted of holdings of shares in 30 companies, with 20 of which the present appeal is concerned, being the companies which issued the debentures in question. The Commissioner has divided these 20 companies into two groups; in the first group all the capital was ordinary share capital, wholly held by the trustees in their own name or through nominees, the trustees being the beneficial owners of all the shares, and the debentures were issued wholly in the name of the trustees. In the second group, the trustees and their nominees did not hold all the ordinary share capital, the other shares benig held by others of the 30 companies, and in one case, that of the Calcutta Discount Company, certain shares were held by two of the trustees individually. In the case of each company in the second group an issue of preferred ordinary shares was made to the trustees alone, and the debentures in question were thereafter issued to the trustees in respect of the holding of preferred ordinary shares.

The questions of law arose in course of an assessment for super-tax and surcharge made by the Income-tax Officer upon the respondents, as trustees of the late Sir David Yule, for the year ending March 31, 1932, in respect of Rs. 5,71,30,000, being the nominal amount of certain bonus debentures issued to them in respect of their shareholding in certain companies in the year ending March 31, 1931.

***Held*—, affirming the decision of the High Court of Calcutta, that, by this transaction no income, profits or gains accrued or arose or was received by the trustees within the meaning of Section 4 of the Indian Income-tax Act and the trustees were not liable to be assessed to income-tax in respect of the debentures."**

If the accumulated profits which remained undistributed could legally be deemed to have been distributed, the personal assessment for super-tax would have yielded a very large revenue to the State. As the profits were distributed by way of (bonus share or) debentures they were converted into capital and could not be taxed. If, however, the accumulated profits are distributed in cash then it is taxable

In Maharaj Kumar Gopal Saran vs. C I T, Bihar, 1935, I T R 237, Maharaj Kumar Gopal Saran, proprietor of nine annas share in the estate, transferred to his Co-sharer (Rani Bhubaneshwari) a large portion of his Zamindari The consideration for this transfer was

1) a lump sum to the transferor,

(2 an annual payment during his life time,

(3) discharge of the outstanding debts of the transferor

After the transferor's death, the property is to go to his daughter who has been married to the son of the Rani The annual payment was assessed to income-tax and super tax Maharaj Kumar, the assessee transferor contended that the annuity payments were payments or instalments of purchase price and hence a capital sum As the annual payment was secured by a charge upon the property transferred this payment, if at all income should be agricultural income and therefore again not assessable The High Court held that the annual payments were income--not capital

In Minister of National Revenue, Canada *vs.* Catherine Spooner, (1933, I T R 299), before the Privy Council on an appeal from the Supreme Court of Canada (P. C. No. 72 of 1932) the case was as follows.

" Mrs Spooner, the assessee was the owner of a freehold property who entered into an agreement with Vulcan Oils, Ltd., whose object was "drilling for and procuring the production and vending of oil." Mrs Spooner sold to the company all her rights, title and interest in and to twenty acres of her land subject to royalties hereinafter reserved. In consideration of the said sale the company agreed to pay to Mrs. Spooner the sum of 5,000 dollars in cash on the execution of the agreement . . . the royalty hereby

reserved . . . *viz.*, 10 per cent. of all the petroleum, natural gas and oil produced and saved from the said lands free of costs."

It was observed there that "the question whether a particular sum received is of the nature of an annual profit or gain or is of capital nature does not depend upon the language in which the parties have chosen to describe it. It is necessary in each case to examine the circumstances and see what the sum really is . . ."

Held, that the share of the oil reserved to the assessee was not a 'royalty' in the ordinary sense familiar in the case of mining leases, but was in effect payment by instalments of part of the price of the lands which she had sold to the company; it was not 'income' but a capital receipt and the amount paid to the assessee was not assessable to income-tax.

In Inland Revenue Commissioners *vs.* British Salmson Aero Engines, Ltd., before the court of Appeal (1939, 7, I.T.R. 245, the case was as follows:—

An English company acquired the sole licence to sell Aeroplane Engines made by a French company. "As consideration for the licence thus granted to them, the licensees shall pay to the contractors, *i.e.*, the French Company—the sum of £25,000 payable as follows . there shall be paid in addition to the foregoing payments, and as royalty £2,500 twelve months after the signing of the agreement and a like sum each 12 months during the following 9 years".

It was observed "on the face of the agreement, the payments to be made under it in terms fall under two heads: one is what is expressed to be consideration for the licence granted, a lump sum of £25,000 payable in specified instalment, the other what is described as an additional payment as royalty of £2,500 a year".

"The Special Commissioners, on appeal to them, decided in favour of the company with regard to the first of those two classes of sums. Those sums, they held, were instalments of the capital sum of £25,000 whereas the sums under the second class, they held, were sums paid in respect of the user of the patent, and the appellants were assessable in respect thereof . . ."

It was also observed "What has to be ascertained in these cases is the true nature of a payment; that is to say, the true nature from an accountancy point of view; . . ."

"Income-tax, as has been said over and over again, is a tax on income. It does not tax capital. As the corollary to that in ascertaining profits, payments of a capital nature may not be deducted. It is income all the time which has to be considered under the Income Tax Acts, and when I find that in Section 25 the Legislature in terms prohibits deductions on account of any royalty or other sum in computing profits, I can only read that as meaning that they are prohibiting a class of deduction in the ascertainment of profits, which, but for such prohibition, would have been legitimate; that is to say, a class of deduction which was of an income, as distinct from a capital nature. Similarly, the direction to the person paying the royalty or sum to deduct, or giving the authority to deduct, the tax, relates to royalties or sums of the same character, that is to say, sums of an income nature. Nobody is going to dispute that the general type of payment, there described "royalty or other sum paid in respect of the user of a patent", is of an income nature, and payments of that kind, in the common form, of a royalty per machine, or so much based on turnover, and so forth, common commercial payments, are unquestionably of an income nature."

"There were in 1925, and there have been since, many cases where this matter of capital or income, has been debated There have been many cases which fall on the borderline: indeed, in many cases it is almost true to say that the spin of a coin would decide the matter almost as satisfactorily as an attempt to find reason. But that class of question is a notorious one, and has been so for many years ."

"It has been said that the question is one of fact, and it is, when one gets to the bottom of it, an accountancy question. In saying that it is a question of fact, it does not mean that, in deciding it questions of law may not have to be discussed and decided . . . ."

"Where the Special Commissioners are skilled persons in matters of business, if on an analysis of the business arrangements out of which the case has arisen, they come to the conclusion as business men that a particular payment has what my Lord has called the accountancy quality of a capital payment or an income payment, that is a view to which, in my opinion, the court is entitled and ought to give great weight. The position is analogous to the case of a trial in the Commercial Court before a city

of London special jury, on a question of business and keeping of accounts, where the special jury have expressed a view on the issue whether a particular payment is a capital payment or an income payment. In such circumstances the Court ought to be very slow to disagree with such a skilled opinion."

Held, that the Commissioners' conclusion is correct.

In Secretary of State for India *vs.* Scoble and others, 4 Tax cases 618, the Secretary of State for India purchased an undertaking and paid an annuity for a term of years instead of a lump sum. In the House of Lords, Lord Chancellor said :—

" Under the circumstances, I think I am at liberty so far to analyse the nature of the transaction as to see whether this annual sum which is being paid is partly capital, or is to be treated simply as income, and I cannot disagree with what all the three learned Judges of the Court of Appeal pointed out, that you start upon the inquiry into this matter with the fact of an antecedent debt which has got to be paid; and if these sums, which it cannot be denied are partly in liquidation of that debt, which is due are to be taxed as if it was income in each year in which it is being exacted, the result is that you are taxing part of the capital. As I have said, I do not think it was the intention of the Legislature to tax capital and, therefore, the claim as against those sums fails.

My Lords, as I have already said, I do not think it is a matter on which one can dogmatize very clearly. There is no doubt that what has been pointed out is true, that in one sense the Legislature has, in the sense in which I have used the words myself, taxed capital. Where you are dealing with income-tax upon a rent derived from coal, you are in truth taxing that which is capital in this sense, that it is a purchase of the coal and not a mere rent. All I have to say upon that and other illustrations of the same character is this, that the income-tax is not and cannot be, I suppose from the nature of things, cast upon absolutely logical lines, and that which justifies the exaction of the tax under these circumstances is that the things taxed have either been or have been by construction by Courts held to be what has been specifically made the subject of taxation: and my answer to an argument derived from those circumstances here is, that look-

ing at the words here used and the word 'annuity' used in the Act, I do not think that this comes within the meaning which (using the Income-tax Acts themselves as the expositors of the meaning of the word) is intended to hit at by the word "annuity" which is the only word that can be relied upon here as justifying what would otherwise be to my mind a taxation of capital."

In C.I.T., Madras *vs.* B. J. Fletcher, 1937, I.T.R. 428 (P.C.), the case was as follows :—

> "The assessee was an employee of the Buckingham and Carnatic Company, Ltd., and was paid a monthly salary with a half-yearly bonus, both of which were taxed in the ordinary course, and his liability in this respect was not challenged. He retired in February, 1933, and was then entitled to receive from the company a sum of Rs. 36,794 which stood to his credit at that date in a fund called 'The Officers' Retiring Fund. 'It is with this sum that the present appeal is concerned."

Assuming that the sum in question was a "profit" arising from the respondent's employment, the question still remains whether it was received by him as income or was in the nature of capital. If it represented merely the payment of accumulated portions of a salary held up by the employers until the employee's retirement, it would, their Lordships think, be received by him as deferred income and, therefore, be taxable, and it is on this question that the decision of the case must turn. Their Lordships have no doubt that the answer must depend mainly on the constitution of the fund. The first point that emerges from an examination of the rules set out above is that the sums to be allotted were entirely in the discretion of the company. They were not bound to make any allotment in any year, and it was only if an allotment was in fact made that the officer concerned could have any claim. This of itself tends to negative the idea that the allotments were part of the officer's current salary. Nor is it suggested that it was part of the respondent's original contract of service that he should have the benefit of this fund; and unless the company chose to put him on the list he would have no interest whatever in it. Even when so listed, he would have no rights until he had served continuously and satisfactorily for a period of six years. And in no case could he make any claim upon the sums

allotted to him until he retired. If he died before retirement the payment of his share would be made to his legal representative, and the appellant's Counsel concedes that in that event no tax would be payable. The consideration of these factors leads their Lordships to the conclusion that the allotments made to the fund in the name of an officer of the company were not in the nature of salary for current services, but were merely the measure of a sum which the company volunteered to pay to him on the termination of his service, and that this sum, when paid, was not "income" and, therefore, not taxable.

The above decision has been made ineffective by Sec. 7, Explanation 2 of the new Amendment Act of 1939.

Section 4.—(1) Subject to the provisions of this Act, the total income of any previous year of any person includes all income, profits and gains from whatever source derived which—

(a) are received or are deemed to be received in British India in such year by or on behalf of such person, or

(b) if such person is resident in British India during such year,— ...

(i) accrue or arise or are deemed to accrue or arise to him in British India during such year, or

(ii) accrue or arise to him without British India during such year, or

(iii) having accrued or arisen to him without British India before the beginning of such year and after the 1st day of April, 1933, are brought into or received in British India by him during such year; or

(c) if such person is not resident in British India during such year, accrue or arise or are deemed to accrue or arise to him in British India during such year:

Provided that there shall not be included in any assessment for the year ending on the 31st day of March, 1940, both the amount of the income, profits and gains referred to in sub-clause (ii) of clause (b) and the amount of the income, profits and gains referred to in sub-clause (iii) of clause (b) but only the greater of these two amounts:

Provided further that, in the case of a person not ordinarily resident in British India, income, profits and gains which

accrue or arise to him without British India shall not be so included unless they are derived from a business, controlled in or a profession or vocation set up in India or unless they are brought into or received in British India by him during such year:

Provided further that if in any year the amount of income accruing or arising without British India exceeds the amount brought into British India in that year, there shall not be included in the assessment of the income of that year so much of such excess as does not exceed four thousand five hundred rupees.

Explanation 1.—Income, profits and gains accruing or arising without British India shall not be deemed to be received in or brought into British India within the meaning of this sub-section by reason only of the fact that they are taken into account in a balance-sheet prepared in British India.

Explanation 2.—Income which would be chargeable under the head 'Salaries' if payable in British India and not being pension payable without India shall be deemed to accrue or arise in British India wherever paid if it is earned in British India.

Explanation 3.—A dividend paid without British India shall be deemed to be income accruing and arising in British India to the extent to which it has been paid out of profits subjected to income-tax in British India.

(2) For the purposes of sub-section (1), where a husband is not resident in British India, remittances received by his wife resident in British India out of any part of his income which is not included in his total income shall be deemed to be income accruing in British India to the wife.

(3) Any income, profits or gains falling within the following classes shall not be included in the total income of the person receiving them:—

(i) Any income derived from property held under trust or other legal obligation wholly for religious or charitable purposes, and in the case of propety so held in part only for such purposes, the income applied, or finally set apart for application, thereto.

(ia) Any income derived from business carried on on behalf of a religious or charitable institution when the income is applied solely to the purposes of the institution and—

> **(a) the business is carried on in the course of the carrying out of a primary purpose of the institution, or**
>
> **(b) the work in connection with the business is mainly carried on by beneficiaries of the institution.**

(ii) Any income of a religious or charitable institution derived from voluntary contributions and applicable solely to religious or charitable purposes.

(iii) The income of local authorities except income from a trade or business carried on by the authority so far as that income is not income arising from the supply of a commodity or service within its own jurisdictional area.

(iv) Interest on securities which are held by, or are the property of, any Provident Fund to which the Provident Funds Act, 1925 applies.

(vi) Any special allowance, benefit or perquisite specifically granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit.

(vii) Any receipts not being receipts arising from business or the exercise of a profession, vocation or occupation, which are of a casual and non-recurring nature, or are not by way of addition to the remuneration of an employee.

(viii) Agricultural income.

(ix) Any income received by trustees on behalf of a recognised provident fund as defined in clause (a) of section 58A

In this sub-section "charitable purpose" includes relief of the poor, education, medical relief, and the advancement of any other object of general public utility, but nothing contained in clause (i), clause (ia) or clause (ii) shall operate to exempt from the provisions of this Act that part of the income of a private religious trust which does not enure for the benefit of the public.

Section 4.—(1) is intended to state the classes of assessees to which the Act applies, *viz.* :—

> (*a*) Resident,
>
> (*b*) Not ordinarily Resident.

and section 4A is intended to state the definitions of

(A) 'Resident' in respect of

(1) Individual,
(2) Hindu undivided family,
(3) Company.

(B) 'Not ordinarily Resident' in respect of

(1) Individual.

(C) 'Ordinarily Resident' in respect of

(1) Hindu undivided family.
(2) Company.

From the above, one question naturally arises as to why a negative definition is given in (B) above and others in the positive forms.

This differentiation being deliberate there must be some significance Does it mean that the negative does not follow from the positive or vice versa?

Though this impression is conveyed by the differentiation, still on reading the whole Act it will be seen that the framers of the Act never contemplated that negative will not follow from positive or vice versa Therefore what may be the explanation of this negative form? This question gave a good deal of trouble to the members of the Assembly:

"Mr. S Satyamurti :—Are these accumulative or alternative conditions? The Honourable Sir James Grigg —They are accumulative. . . The reasons why it was put in the form of an accumulation of negatives is that it was discussed at great length and I think the general consensus of opinion was that in order to get an accumulation of conditions only using positives it will be necessary to complicate the provisions and that this was a more compendious way of doing it."

Mr. S. P. Chambers also used the positive form of "Not ordinarily resident" in the debates of Council of State when he used ordinarily resident in spite of the fact that ordinarily resident has been nowhere defined and

what is defined is purposely and deliberately put as "not ordinarily resident" within inverted commas. This meant a technical expression but we are convinced we should not take it seriously. Sec. 4B (b) & (c) mentions positive forms.

The new Act takes into consideration that many Indian businessmen carry on business outside India but every year or in alternate years or at odd intervals they return to their homestead and stay for sometime. This matter will be further clarified from the following speech :—

The Honourable Sir James Grigg :—Sir, I will do my best to solve conundrums. In the first place, we were trying to cover rather compendiously two entirely different classes of cases, firstly the European official or the trader for that matter in the early years of his stay in India before it has become established that his career is in India. The other is the case of the Indian trader abroad who has an ancestral home in India to visit irregularly but possibly enough to become technically resident in every year. The conditions to be satisfied are cumulative, that is a man has to be resident in nine out of ten years preceding the year of assessment. Now that means that there are three ways in which a man can become resident. He can become resident by being in the country for six months, he can become resident if he has got a house in the country and comes here for one day; he can become resident in a year if he is here for a day, if he has been here before that year for one year out of four, *i.e.*, a regular visit of about three months a year. Any one of these definitions of "resident" or one or other of these definitions of "resident" has got to be satisfied in nine out of ten years. Then you come to the second wing, to the case where a man becomes a resident technically in every one of the ten years although his visits are very short and he becomes resident in the main in fact entirely, because he keeps an ancestral house in British India; and therefore unless he is in India for a substantial period over 7 years he is to be regarded as not ordinarily resident. That was the object which the Leader of the Muslim League party had, that is, to cut out the Indian trader whose connection with India had become rather attenuated and only existed at all because he

had an ancestral house and came back to it at odd intervals for short periods. So that a man is not ordinarily resident unless he satisfies both of those conditions and both of those conditions amount to saying that he must have been resident in nine out of ten years and he must have been here for substantial periods in the preceding seven years. And those are the criteria we have invented to cover two different types of cases. There are two cases in which a man may become resident by being in India for a single day for a tax year. The first is that he has got a furnished house and he occupies it and the second is, if he has been a regular visitor for substantial periods for four years preceding that year, and the criterion for that is that he has been here for one year in the preceding four. And in both cases a man can technically become resident by being in the country for one single day. And you cannot exclude the rather absurd extreme case where a man has been here for (say) one day in nine years out of the preceding ten and becomes ordinarily resident by that criteria alone. And that was the object which not only Mr. Jinnah, but the Leader of the Congress party had in mind, to cut out the person whose connection with India had become so attenuated as to be non-existent.

The Honourable Mr. S. P. Chambers in the Council of State, said:—Under the bill as it now comes to this council, tax-payers are divided into three classes. First, there are the non-residents. They pay tax on the amounts which arise in British India. Then there are the persons who are resident but not ordinarily resident. They pay tax on the amounts which arise in India plus the amount of their foreign income which they bring into British India. And then, finally, there are those who are both resident and ordinary resident. I will come to the way in which these classes are defined in a moment. But this last class pays tax on the income which arises in India, on the amounts they bring to India and also on the amounts which arise abroad and which have not been brought into India, with a deduction from his last class of income of Rs. 4,500. So much for the incidence of taxation between these three classes. I think the chief trouble has arisen not so much in understanding that but in understanding the differences made between the classes, the manner in which the different classes have been defined. This matter is dealt with * * * in section 4-A and 4-B. Now under the new section 4-A a person is resident in British India if he satisfies one of the three

conditions. First of all he has to be resident in British India (or rather actually in British India) for at least half the year. This is one condition. Secondly, if he has a house in British India maintained for at least half a year and visits the country for any time during the year, however small the period may be, he may be here only two or three days; he would then be regarded as a resident. And thirdly, if in the preceding four years he has been in British India for at least 365 days, he will be regarded as resident. Now that differentiates residents from non-residents. We will have to keep those three conditions entirely separate from the conditions which are dealt with in the second section, section 4-B, which defines persons who are ordinarily resident. Now under 4-B, a person in order to be ordinarily resident must have been a resident as defined in 4-A for at least nine out of the ten preceding years and must also have been in British India for at least 730 days (that is to say two years), in the previous seven years. Both those conditions have to be satisfied. If I give one or two illustrations, perhaps it might make the thing clearer. First of all, let us take the case of a Sindhi merchant; I mention the Sindhi merchant because that is a class affected, who maintains a house in British India, trades abroad and comes back regularly every year. He will clearly be a resident of British India, but unless he has also been for 730 days out of the past seven years in British India he will not be also ordinarily resident. He would just be treated as a person resident but not ordinarily resident, and will pay tax on the income in British India plus the income arising abroad which has been remitted to British India. Then, if you take the case of a European member of the Indian Civil Service who has been here for eight years, he will be regarded as not ordinarily resident, because quite clearly he has not been resident in British India for nine out of the previous ten years. But his colleague, also a European member who has been here 12 years, and has only had short periods of leave, eight or nine months at a time will be regarded both as resident and ordinarily resident. In order to escape, a person who has been resident here for more than ten years will have to be out of the country for the whole of two complete income-tax years; otherwise the condition of ordinary resident will apply to him.

So far I have been dealing with the question of residence in its relation to individuals· but an important change has been made in defining what we mean by a company resident in British India.

In the past a company was regarded as resident in British India unless its control and management was situated wholly outside the country. The Bill adds another condition and says that a company shall be regarded as resident if its control and management is here or if more than half its income arises here. That is a change which has been made in the Assembly and the effect of that is to bring within the scope of the Act those companies which have most of their trading activities in India but which have their technical control in the United Kingdom. By technical control I mean control as it has been interpreted in the Courts, the control of the Board of Directors if the power of control is vested in that Board. If those meetings are all held in London, then, notwithstanding the existence in India of large buildings and most of their business here, then technically that company will be regarded as resident in the United Kingdom and not resident in India. These companies paid in the past on the income arising here, but they did not pay on the income arising abroad, the United Kingdom or elsewhere. That is rather an important change. Fortunately for a company "ordinary residence" is the same as "residence". So there is no further complication here"

Suppose an Indian trader doing business in South Africa comes to his ancestral house every year for a month, he may have technically become resident every year and for nine years, still he will not be "ordinarily resident" until he can prove that he has also been in British India for over 2 years during the last 7 years.

Conversely, if another trader can show that he has been in British India for more than 2 years during the last 7 years, he will be ordinarily resident if he can also prove that he has been a resident (according to 4-A) for 9 years out of the preceding ten years.

It may be repeated here that to prove an individual "not ordinarily resident", one of the two conditions has got to be fulfilled. It is only when an individual is to get the status of "ordinarily resident" that the two conditions must be at once satisfied.

The incorporation of this clause has a history behind it. The idea is to give the utmost consideration to the

peculiar situation in which the foreigners are placed in the first few years of their domicile in this country and also in which the Indians are placed by the exigencies of their business, *viz.*, they do their business outside India but every year or in alternate years or at odd intervals they return.

Illustration 16 :

An Englishman comes to India and resides for 5 months. He is not resident and he is " not ordinarily resident ".

Illustration 17 :

An Englishman comes to India and resides for 8 months. He is resident but "not ordinarily resident".

Illustration 18 :

An Englishman comes to India and remains for full 9 years. He is resident but still "not ordinarily resident". Out of past 10 years less than 9 years residence must be proved for being put in the category of "not ordinarily resident".

Illustration 19 :

An Englishman comes to India and lives 10 years He is resident because

(1) he has spent over 1 year in British India during the past 4 years.

(2) he has been resident (as defined) for 9 years out of the preceding 10 years.

(3) he has been in British India for more than 2 years.

Previous year is 1941-42. 10 years must be completed on 31st March 1941. Out of these 10 years he must be resident for 9 years.

Illustration 20 :

An Englishman came to India 16 years ago in some service and 2 years ago took leave for 14 months. He is

resident and ordinarily resident. Resident because (1) he has been in British India for more than 365 days during the past 4 years.

Ordinarily resident because (1) he has been resident (as defined) for at least 9 years out of 10 years, and (2) he has been in Br. India for more than 2 years during the last 7 years.

Illustration 21 :

If the man in the above illustration, had taken leave for 2 years instead of 14 months and been away from India for 2 years :

He is resident because he has been in British India for more than 365 days during the past 4 years; and 'not ordinarily resident' because he has not been in British India for more than 2 years during the past 7 years

Illustration 22 :

An Indian merchant in London having no dwelling place in India comes to British India every winter for 3 months every year for the last 8 years

He is resident because he has been in British India for 1 year (365 days) during the past 4 years; and he is 'not ordinarily resident' because the total period during the last 7 years is 21 months which is less than 2 years.

Illustration 23 :

An Indian merchant carrying on business in Java having no dwelling place in India comes to British India for mere travel every 2 or 3 years and lives for a month or so.

He is non-resident. He is not taxable, however large his income may be in Java. If this man remits out of his income Rs. 300 per month to his banking account in British India, this remittance will not be taxed. But if this remittance is sent to his wife, his wife will be assessed on this.

Illustration 24:

B, an employee of an Insurance Company of Calcutta, is in charge of a branch office at Indore. As he is a private employee earning in a State in India and is paid outside British India, he is not liable to British India tax.

If in any year he happens to come to his home where he has a dwelling place he becomes a Resident but not ordinarily resident. In such a case he will pay tax on

(A) All income arising in British India.

(B) Other incomes arising outside British India if it is brought into British India.

(C) Income arising outside British India from any business controlled in *India* or from profession set up in India subject to a deduction of Rs. 4,500

Illustration 25:

But if the above employee's salary is received on his behalf by a bank in British India, he is taxable.

Illustration 26:

But if the above employee receives the salary at Indore and then remits it to his Calcutta Bank, it is not taxable.

Illustration 27:

C, a retired Government Pensioner, settles in Hyderabad. According to section 4(1)—Exp. 2, he is assessable.

Illustration 28:

C, a retired Government Pensioner, settles in London. He is assessable under section 4(1)—Exp. 2; and section 60.

Illustration 29:

D, a pensioner of a zamindari estate, settles in Hyderabad. According to section 4(1)—Exp. 2, he is assessable.

Illustration 30 :

C and D above as non-residents will have to pay tax under section 42, if there is an agent, as their income arises from a source of income in British India; if there is no agent, he will be directly assessed under the same section.

NOTE.—It is very doubtful as to whether a man for whom particularly no dwelling place is maintained in India can be taxed.

It may not be effectively contended by I.T.O. that an ancestral home in which he has a right to live is a dwelling place "maintained for him."

Sterling Tea Company

The next difficult question that arises is about the sterling tea companies whose total income consists of both Indian and foreign income

Foreign income—	*Indian income—*
Rs. 18,000	Rs 40,000 of which
	60% Rs. 24,000, agricultural,
	40% Rs. 16,000, non-agricultural.

The **first contention** is that if the income refers to the 100% profits of the tea gardens, then by the very nature of things where 60% is accepted by statute as agricultural, the company is always resident

The **second contention** is that if income in this case refers to 40% (taxable income) then in the above case, foreign income exceeds the non-agricultural income and therefore the company becomes non-resident. Residence therefore depends on the amount of income from foreign investments; if it is increased, it may become a non-resident company provided of course the question of control and management is also proved.

Certainly the second contention is very weak and unenable.

The **third contention,** to make the question more complicated, may be that the agricultural income of Rs. 24,000 which is alleged to have arisen in British India has, according to *Mohanpura Tea Company decision* backed by the inference from the decision of the judicial committee of the Privy Council in the case of *S. L. Mathias*, arisen in U. K. where actually major portion of the sale takes place. Therefore the sterling Tea companies may be almost successful in establishing that their companies are non-resident. The weakness in the argument lies in the fact that the Privy Council refrained from answering, in the Mathias's case, as to *where* the agricultural income arose—it only answered that Section 4(2) 2nd proviso did not apply. [See Section 42(3) which provides that manufacturing profits in India will be taxed.]

Illustration 31.

Lucknow Investment Company, Limited.

(Ordinarily Resident Company).

The company received Rs 20,068-0-0 (gross) from foreign investments and did not bring it into India and received Rs. 22,021-14-0 (net) from dividends of various Indian Companies as per Profit and Loss A/c below :—

To Managing Agents' remuneration	Rs 3,250-0-0	By Dividends from Investments :—	
,, General Charges	1,870-0-0	Foreign	Rs.13,858- 2-0
,, Difference in exchange	1,200-0-0	Indian	Rs.22,021-14-0
,, Share Transfer Stamps and Fees	1,630-0-0		
,, Interest	2,520-0-0		
,, Net profit	25,410-0-0		
	Rs.35,880-0-0		Rs.35,880-0-0

Solution :—

Statement of Income

(1) Foreign income received outside India and not brought into India Rs. 20,068-0-0 (Gross.)

(2) Dividends received in India after deduction of tax at source Rs. 22,021-14-0 (net) or

Rs. 26,100-0-0 (gross)

Expenses allowed —

Remuneration	Rs 3,250-0-0
General charges	1,870-0-0
Interest	2,520-0-0
	Rs 7640-0-0

Therefore Expenses allowed

(1) [illegible] 7640 Rs 2950-12-11

(2) [illegible] 7640 Rs 4689-3-1

Total Income —

(1) Foreign income received outside India and not brought into India (gross) Rs 20,068-0-0

Less expenses	2950-12-11	
" statutory deduction	4,500-0-0	
	Rs 7450-12-11	Rs 7,450-12-11
		Rs 12,617-3-1
(2) Dividends in India	Rs 26,100-0-0	
Less expenses	4,689-3-1	
		Rs 21,410-12-11
		Rs 34,028-0-0
I T on Rs 34,028 at 30 pies		Rs 5,315-12-0
Less relief Rs. 26,100-0-0 (gross)		
Rs 22,021-14-0 (net)		
Credit Sec. 18(5) Rs 4,078-2-0		Rs 4,078-2-0
	I. T payable	Rs. 1,237-10

Super-tax at -/1/- flat rate on Rs. 34,028 = Rs 2,126-12-0.

NOTE.—(*a*) When an individual has a large amount of income from securities or house properties, he should make a private limited company with them. The advantage will be that this company will be super-taxed at -/1/- in the rupee. In his individual assessment, had it not been a limited company, the income-tax rate would have soared up and also a larger super-tax would have been payable as individual.

(*b*) Such company, if assumed to be U. K. company, should remodel the company slightly by

(*i*) Converting some of its Indian securities into English Securities to make the foreign income more than Indian income and

(*ii*) Showing that the managing director remains in England and controls the policy,

and then the company would be non-resident and no tax would be payable except on the Indian income.

(*c*) Refund on the foreign income will be allowed under Double Income tax Relief Sections.

(*d*) The Act provides that a company is resident if its income arising in British India in that year exceeds its income arising without British India. An obvious difficulty arises as to whether agricultural income should be counted an instance is given below:—

Foreign Income	British Indian Income	
Rs. 40,000-0-0	Rs. 44,000-0-0 of which	
	(a) Agricultural	Rs. 24,000-0-0
	(b) Non-agricultural	Rs. 20,000-0-0

The word 'income' (*not* "assessable income") has been used.

Agricultural income is also income though it is not added for assessment purposes but for purposes of Section

4A(*c*)(*b*), *i.e.*, comparison of two incomes, whether agricultural income should be taken into account or not is a ticklish problem. Arguments seem to be against inclusion on the basis of the decision in Nagin Chand Shiv Sahai *vs.* C.I.T., Punjab, 1938, I.T.R. 534 where the judgment stated that the word "income" "connotes the assessable figure", though the judgment was dealing with another section (Section 28). To give an ordinary construction to this word, income should include agricultural income.

In the old Act the expressions "deemed under the provisions of the Act to accrue, arise or be received in British India" referred to the specific provisions of the old Act, *viz.*, 4(2), 7(2), 11(3) and 42.

But in the new Act the words "under provisions of the Act" have been omitted with the result that the word "deemed" has to be interpreted and ascertained.

In the old Act the question of domicile was very important but in the new Act what is very important is the question of *residence*.

NOTE.- (1) Mere recording (of profits derived elsewhere out of British India) in the Balance Sheet prepared in British India is not a case of profits "deemed to be received or brought into British India."

(2) The expressions "accrue or arise" point at ownership, while "received" is actual possession. There does not seem to be any appreciable distinction between the words 'accrue' and 'arise'. They mean the same thing, but if any very fine and subtle distinction exists it is in the use of the terms, *e.g.*, interest on securities *accrues* and income or profit of a business *arises*.

In Subramanyan Chettier vs. C.I.T. Madras, (1935 I.T.R 295), assessee had business both in Tinnevalley and Penang (outside British India). He contracted a debt in his Tinnevalley Shop. In order to repay this debt he issued to his creditor 'hundis'

on his Penang firm; the debt was thus discharged. It was decided that it was a case of constructive receipt as discharge of Tinnevalley debt amounted to a receipt in India by the Assessee of his gains outside British India.

In Saunders *vs.* C.I.T U.P., (1932, 5, I.T.C, 453), Bishop of Lucknow was paid from a fund in U.K. and the allowance was payable only in U.K. The Allahabad High Court held that the income accrued in India.

In Sir T Vijayaraghavacharya's case (1936 I.T R 317), he was paid in U.K The Lahore High Court decided that "pay, leave salary, pension paid outside India to persons residing in India" was exempt from tax just as payment made to persons residing out of India Therefore in this case income has been taken to arise at the place where payment to the assesee has been made --not where "earned" nor where the source is situated.

In the matter of V.G Every in the Calcutta High Court (1937, I T R 216), Justice Panckridge observed:—"In my opinion, the words *accruing and arising* are very wide and I am in full agreement with those decisions of the Bombay High Court, which have laid it down that they mean something different from *being received* This view receives support from the language of section 4(2) which specifically recognises that income, profits and gains may arise or accrue at one place and be received at another."

For an answer to item 6 (on page 2) the following case is more or less appropriate :—

In C I T Bombay *vs.* The Ahmedabad Advance Cotton Mills, Ltd, (1938, I T R 31) an income arose in England from sterling investments This income was then utilised in purchasing some assets for the Bombay Company. When this machinery was brought to Bombay, the question naturally arose as to whether income to the extent of the value of the machinery is not income remitted to India and as such taxable. The Bombay High Court held that income was not brought but capital asset was brought to India and therefore not taxable.

In C.I.T., Bombay, *vs.* Chunilal Mehta, 1938, I.T.R. 521, the Privy Council gave its judgment on the following case :--

"The assessee has been trading in Bombay for several years past as broker and speculator in cotton, silver and other commo-

dities. He has his office in Bombay only. He has also income from properties and dividends on shares in joint stock companies. As regards the speculation business, the assessee does this on his own account as well as on account of his constituents and he carries on his business not only with parties in British India but also with parties outside British India, *e.g.*, at Liverpool, London and New York. Profit or loss from such business as is done on his own account is his. As regards business done on account of his constituents, he charges brokerage and the profit or loss arising therefrom is theirs.

As in this connection, it is necessary to have some idea of the exact manner in which the assessee does this speculation business, I beg to refer here to an actual transaction to show how it was put through. Taking up the New York Cotton Exchange, on October 29, 1930, the assessee sent a telegram to A. Norden & Co. of New York asking them to "Buy 500 March at the closing". This was done at 11.74 cents per pound (a bale containing 500 lbs). On December 1, the assessee sold the 500 bales by sending again a telegram to the above firm asking it to sell. The difference between the purchase and sale price amounted thus to dollars 2,250 which the assessee had to pay along with the amount of dollars 90.21 charged by the firm on account of brokerage and other expenses. The assessee neither paid the purchase price nor recovered the sale price nor did he take or give delivery of the said 500 bales. He paid only the difference between the two prices. (This is also what he would do with a broker in Bombay while dealing with a party here.) All that is to be done in a business of this kind is thus merely to issue an order to a broker for forward purchase or sale and then issue another order closing the transaction.

These considerations lead their Lordships to the conclusion that under the Indian Act a person resident in British India carrying on business there and controlling transactions abroad in the course of such business is not by these mere facts liable to tax on the profits of such transactions. If such profits have not been received in or brought into British India it becomes or may become necessary to consider on the facts of the case where they accrued or arose. Their Lordships are not laying down any rule of general application to all classes of foreign transactions, or even with respect to the sale of goods. To do so would be nearly impossible and wholly unwise—to use the language of Lord Esher

in Erichsen *vs.* Last. They are not saying that the place of formation of the contract prevails against everything else. In some circumstances it may be so, but other matters—acts done under the contract, for example—cannot be ruled out *a priori*. In the case before the Board, the contracts were neither framed nor carried out in British India; the High Court's conclusion that the profits accrued or arose outside British India is well founded."

Therefore, for the determination of the place where profits have accrued, the principal determining factors are :—

(*a*) the place of formation of contract,

(*b*) the place of sale, and

(*c*) the place of the receiving agent.

In the matter of Howrah-Amta Light Railway, Co., Ltd. (1928, A.I.R. 579), there was an agreement between a District Board and a Tramway Company as to the free use by the latter of as much portion of a certain road as was necessary for laying a tramway. The judgment of Rankin C. J. runs as follows :—

" . . It is the fifth clause which is the most important: 'If and whenever the net profits of the company in respect of the said tramway from Howrah to Amta should be in excess of 4 per cent upon the capital for the time being of the company such surplus profits shall be divided between the company and the Board in equal moieties."

"Now the second question to which I have referred has reference to the sum which the Tramway Company, the Light Railway, has to pay to the District Board as being one half of the surplus profits in excess of 4 per cent. upon the capital for the time being. In my judgment this is a typical case in which to apply the well-settled principle that the destination of profits has got nothing to do *prima facie* with the question whether they are liable to income-tax. What may be done with the profits after the tax has been paid upon them is a different matter, but the question is whether the company in this case is liable to pay income-tax upon its profits or only upon that part of its profits which it does not hand over to the District Board under Clause 5."

In the case Raja' Raghunandan Prasad Singh *vs.* C.I.T., Bihar, 1933, I T.R. 113, it was decided that the interest on a mortgage does not accrue to the assessee when the date falls due, but within the meaning of section 4 it accrues when it is actually received. In this case Justice Das quoted Lord Wrenbury's judgment in the case of St. Lucia Usines and Estates, Co., Ltd. (1924) :—

"The words 'income arising or accruing' are not equivalent to the words 'debts arising or accruing'. To give them that meaning is to ignore the word 'income' The words mean 'money arising or accruing' by way of income. There must be a coming in to satisfy the word income."

Section 4(1).

Explanation 2.—Income which would be chargeable under the head 'Salaries' if payable in British India and not being pension payable without India shall be deemed to accrue or arise in British India wherever paid if it is earned in British India.

This will cover such cases, where, by agreement, salary or allowances or any remuneration is payable in U K, though the men would be working in India. Pension, however, which comes under salary, when payable without India, will not be included in the total income Pension seems to be the only remnant out of the exemptions given under section 60 in respect of leave pay, etc. The withdrawal of the exemption of leave pay, etc., drawn in U. K. or from colonial Treasury has been a very desirable modification.

The author gave a suggestion in the first edition as follows :—

"A rupee company in India has some sterling investments in U.K. The dividends declared out of the rupee company profits were paid to British shareholders from the interest on sterling securities. As the law now stands, because the income from sterling securities is not remitted to British India, it is not taxable, but is it not a clear case of constructive receipt and should not interest on sterling securities to the amount of dividends distri-

buted in England be included in the total income of the rupee company and be taxed?"

Section 4(1) Explanation 3 quoted below meets the above case.

Explanation 3.—A dividend paid without British India shall be deemed to be income accruing or arising in British India to the extent to which it has been paid out of profits subjected to income-tax in British India.

Section 4(2).

For the purpose of subsection (1), where a husband is not resident in British India, remittances received by his wife resident in British India out of any part of his income which is not included in his total income shall be deemed to be income accruing in British India to the wife

Remittance sent by husband (in U. K.) will be taxed if the husband has not paid tax in U. K. on it. Thus a person who has no connection with British India beyond maintaining his wife in British India will not escape taxation. The same slice of income (which is now a remittance) should not be taxed twice. When such a remittance is taxed, it will come under Section 4(1)(*a*).

Section 4(3).

The Act does not apply to the following classes of income (both for Income-tax and Super-tax) :—

(*i*) Income claiming exemption must arise from *property held in Trust or other legal obligation*

(*ia*) Income from business carried on on behalf of religious or charitable institution,

if the income is applied solely to the purpose of a charity *and* either

(*a*) the business is carried on in the course of the carrying out of a primary purpose of the charity or

(*b*) the business is carried on mainly by the beneficiaries,

(ii) Voluntary contributions received by a religious or charitable institution,

(NOTE.—*No question of trust*, etc., as above.)

(iii) Income of Local authority,

(iv) Interest on securities held under Provident Funds Act, 1925,

(vi) Special allowance, benefit, etc., to meet expenses wholly, necessarily incurred,

(vii) Casual and non-recurring income.

(viii) Agricultural income,

(ix) Income of Trustees on behalf of recognised Provident fund.

Section 4(3)(i)—Income which claims exemption must arise from property held in Trust. Exemption refers to :—

(a) Income from property which is dedicated absolutely.

(b) In case of qualified dedication, so much of the income as is applied or finally set apart for application to religious or charitable purposes.

"In the case of absolute dedication, *i.e.*, where there is no outstanding secular interest reserved by the trust, the exemption is complete. In the case of qualified dedication, the trust reserves a secular interest to beneficiaries, Shebaits or heirs of the founder, etc. *This secular interest is assessable to income-tax.* Suppose 60 per cent. is under the trust applicable to religious or charitable purposes and 40 per cent. distributable among the heirs of the settlor. The 40 per cent. is assessable. Suppose also that only 50 per cent. is actually applied or set apart for religious or charitable purposes and the heirs of the Shebaits misappropriate 10 per cent. The 10 per cent. is under the section also assessable.

The maintenance of a Shebait may or may not come within the category of religious or charitable purpose. It depends on the circumstances of the case. If, for instance, a dedication is

absolute and a small portion of the income is given to the Shebait for his remuneration for carrying out the trusts of the endowment, it would not be secular. If, on the other hand, a fixed sum is given to religious or charitable purposes and the residue of the income is given to the Shebait for his maintenance, the residue would be held to be secular.

The test is whether a suit for partition lies for division of the residue. If it does, then the residue is secular and assessable. In such case, any portion of the dedicated, *i.e.*, ordinarily exempted income which may be misappropriated would also be assessable." (I.T.M.)

NOTE.—(1) Property may be dedicated to religious purposes still it may not come under the section.

(2) It need not be a formal trust. But there must be legal (by usage or custom) obligation to apply the income to charitable or religious purposes. (Eggar *vs.* C.I.T., Rangoon, 1927, 2, I.T.C. 286.)

(3) If the property is held under trust wholly for religious purposes, the Income-tax Officer has nothing to enquire as to how the income has been applied. When the property is held under trust in part only, the fact that income has been "finally set apart" will be enough for Income-tax Officer.

(4) Property in this section means securities, business and all other properties.

(5) 'Other legal obligation' refers to Wakfs or Hindu Endowments.

(6) A 'Debottar' created by Hindu Law is not a trust. The shebait is not the trustee—certain duties are common—the legal property vests in the deity—shebait is manager of the deity.

(7) The question is that whether a private debottar or a private Wakf for benefit of the public can be said to be under Trust. Probably not.

(8) The trust may be either express or implied. But the implication or inference must be fully justified by the provisions included in the deed or document.

(9) Charitable purpose includes relief of the poor, education, medical relief and advancement of any other object of general public utility, *e.g.*, University, Dharamsala, Poor Feeding House, Dispensary, Hospital, School, Pinjrapool, etc.

(10) A hospital, school or college, etc., need not necessarily be charitable. Such things when proprietary will be taxed.

(11) An institution meant for professional examination is not charitable

(12) Whether any organisation is charitable or not is a question of fact and intention.

(13) Mere benefit, benevolent or liberal purpose will not necessarily bring it within section 4(3) It must be income from property held in trust (Eggar *vs.* C I.T., Burma, 1927, 2, I.T C. 286)

(14) If a 'Temple' is made a member with other individuals as members of a registered firm, the firm cannot claim exemption for the share of the temple because income is not derived from property held under trust. (Lachman Das Narain Das, Cawnpore, 1925, 1, I T.C. 378.)

(15) There should be

(*a*) permanent dedication,

(*b*) entire or substantial dedication,

(*c*) definite part of the property should be dedicated.

(M.I.R., Malak *vs.* C.I.T., 1930, P.C. 226).

(16) If an assessee could completely alter the nature of the fund, and change its management as he liked, and if

also distribution of the proceeds was in his control, it would lack the real elements of trust and his claim for exclusion of income would not be accepted.

(17) The disbursements were within the control and volition of the assessee. There was no setting apart or specification of any part of the property for the charitable purpose. There was no fixity of objectives because wide discretion was given. The claim for exclusion of income was not accepted (Probynabad Stud Farm *vs.* C.I.T., Punjab, 1936, I.T.R. 114).

(18) "That part of the income of a private religious trust which does not enure for the benefit of the public" is not exempt from tax.

(19) A community or one definite section of the public will be included in the expression "public".

(20) If a Trust fails to establish its case for exemption under Section 4(1), then the Trustee will be assessed under Section 41

(21) The Musalman Wakf Validating Act of 1913 fully recognises wakf which is solely intended for maintenance of assessee and his children. But as the income was not devoted wholly to religious or charitable purposes it could not be income within Section 4(3)(*i*). (Umar Baksh *vs.* C.I.T., Punjab, 1932, 5, I.T.C. 402.)

(22) Where the income of the wakf is specifically allocated to a person, tax will be payable according to the total income of the person.

(23) Where the income of the wakf is not specifically allocated to a person or to public charities, tax will be payable according to the maximum rate of income-tax.

(24) Where the income of the wakf is specifically allocated to public charities, no tax is payable.

A Mahomedan who owned several immovable properties executed a deed of wakf in respect of them under which he appointed

himself, his wife and his two sons mutawalees and conveyed to them these properties to be held in trust for the purposes declared therein. The mutawalees were directed to collect the rents, and, after defraying all charges, to pay 1/8th of the balance of the income to the settlor's wife for life and the other 7/8ths to the settlor's children. After the death of the wife the 1/8th was to follow the other 7/8ths and after the extinction of all the children and remoter issue of the settlor the properties were to be held for the use of charitable, religious or pious purposes for the benefit of Sunni Halai Memons.

Held, (1) that the properties, though validly given as wakf under the Mussalman Wakf Validating Act, were not held for charitable or religious trusts; (2) that though the mutawalees constituted an association of individuals within the meaning of Sec. 3 of the Indian Income-tax Act, they were not the 'owners' of the properties within the meaning of sec. 9 of the Act and could not be assessed as regards the income of the wakf properties; but the income-tax authorities were bound to assess the beneficiaries directly in respect of the income of the wakf.

BEAUMONT, C. J.—Though the language of sec. 9(1) seems to involve that the assessee must be the owner of the property from which the income is derived, in order to bring the section into conformity with the general scheme of the Act it is necessary to read the words 'of which he is the owner' as meaning 'of which annual value he is the owner'.

RANGNEKAR, J.—The whole object of the Act is to tax the income of the subject where it is found. If the income is found with the beneficiary he is primarily liable to be taxed, and if the income is found with the trustee, then it is the trustee who is liable. (C.I.T., Bombay vs. Abu Baker Abdul Rahman and others 1939, I T.R. 139).

In Trustees of the Tribune, Lahore, 1939, I.T.R. 415,

a person who owned a press and a newspaper created a trust by his will by which his property in the stock and goodwill of the press and newspaper was made to vest permanently in a committee of certain numbers. It was the duty of the said committee of trustees under the will 'to maintain the said press and newspaper in an efficient condition, and to keep up the liberal policy of the said newspaper, devoting the surplus income of the said press and

newspaper after defraying all current expenses in improving the said newspaper and placing it on a footing of permanency.' It was also provided by an arrangement made subsequently that in case the paper ceased to function or for any other reason the surplus of the income could not be applied to the object mentioned above, the same should be applied for the maintenance of a college which had been established out of the funds of another trust created by the same testator. There was a surplus income in the hands of the trustees after defraying the expenses of the press and the newspaper and on a reference by the Commissioner of Income-tax as to whether this income was liable be assessed in the hands of the trustees, it was held by the Lahore High Court per Young, C. J., and Addison, J., (Tek Chand, J., dissenting) that the income in question was not income derived from property held under trust for charitable purposes as that expression is defined in Section 4(3) of the Indian Income-Tax Act and was assessable to income-tax.

On appeal to Privy Council, Held, reversing the judgment of the High Court—

that the object of the settlor was to supply the province with an organ of educated public opinion and this was *prima facie* an object of general public utility. Though a trust for conducting a newspaper as a mere vehicle for the promotion of a particular political or fiscal opinion may not be within the exemption, where the object is to disseminate news and ventilate opinion on matters of public interest, the fact that the paper may have, or may acquire, a particular political complexion would not take away its exemption.

Section 4(3)(ii). It exempts the income of religious or charitable institutions:

(*a*) which is derived from voluntary contributions, and

(*b*) which is applicable solely to religious or charitable purposes.

"To secure exemption under clause (*i*) or clause (*ii*) of section 4(3) the income of religious or charitable institutions and income derived from property held for religious or charitable purposes need not be actually spent on religious or charitable purposes

in the year of receipt. **It is sufficient if it is set aside for those purposes. In the case of mixed trusts, the income-tax authorities are required to enquire into the application of the income. Where property is held in part only for religious or charitable purposes a proportionate share of any expenses incurred on management should be considered as applied to those purposes." (I.T.M.).**

Voluntary contributions are exempt like those given to Ram Krisna Mission—not those voluntary contributions which are given in exchange for some benefit or advantage.

It seems private Debottar and private wakfs can come under this.

Section 4(3)(iii). The income of local authorities.

"Local authority means a municipal committee, district board, body of port commissioners or other authority legally entitled to or entrusted by the Government with the control or management of a municipal or local fund."

NOTE.—(1) Local authority includes harbour trust boards, improvement trusts, inland navigation boards, water boards, etc.

(2) According to the previous Act, all incomes of a local authority were exempt from tax.

According to the new Act of 1939, all incomes are exempt except income from trade or business carried on by it outside the jurisdictional area of such a body. Hence, the income from supply of any commodity or any service within its own area shall not be assessable.

(3) If the Calcutta Corporation takes up the Calcutta tramway company, then profits from this large business will not be brought under tax, unless, and to the extent, the Corporation extends its services beyond its own area.

(4) It pays income-tax at the highest rate (30 pies).

(5) It pays Super-tax at one anna on every rupee.

Section 4(3)(iv). Interest on securities which are held by or are the property of any Provident Fund to which the Provident Funds Act of 1897 (now Act XIX of 1925) applies.

NOTE.—(1) Provident Funds are invested in Trustee securities (section 20 of the Indian Trust Act).

(2) These are Provident Funds of public servants or quasi-public servants, the constitution and control of which are regulated by Provident Funds Act and rules made thereunder.

(3) The Manager of the Court of Wards is a Government servant for the purpose of the Provident Funds Act. (Rutherford *vs.* C.I.T., Bihar, 1931, 5 I.T.C. 71.)

Section 4(3)(v). Which has been omitted by the Amendment Act of 1939, ran as follows:—

" Any capital sum received—

(*a*) in commutation of pension, or

(*b*) in the nature of consolidated compensation for death, etc.,

(*c*) in payment of insurance policy, or

(*d*) as the accumulated balance or at the credit of a subscriber to any such fund."

The above has been omitted on the ground that these items of receipt are of capital nature beyond a shadow of doubt The Legislature thinks that inclusion of these items is wholly superfluous particularly in view of the observation of the judicial committee in the case of Shaw Wallace: "Some reliance has been placed in argument upon S. 4(3) (*v*) which appears to suggest that the word ' income ' in this Act may have a wider significance than would ordinarily be attributed to it. The sub-section says that the Act ' shall not apply to the following classes of income,' and in the category that follows, clause (*v*) runs:- ' Any capital sum received in commutation of the whole or a portion of a pension, or in the nature of consolidated compensation for death or injuries or in payment of any insurance policy, or as the accumulated balance at th credit of a subscriber to any such Provident Fund.'

Their Lordships do not think that any of these sums, apart from their exemption, could be regarded in any scheme of taxation as income, and they think that the clause must be due to the over-anxiety of the draftsman to make this clear beyond possibility of doubt."

Inspite of these observations of the Privy Council and the assurance of the Legislature, the author ventures to think that the section ought not to have been omitted. Opinions change— interpretation of Privy Council may also change with lapse of time; Legislature may also change its attitude and views. An instance to the point is not very far Debenture has always been regarded as a capital asset according to Indian and English conception of law, according to all principles of accountancy but by the Amendment Act of 1939, Debenture Bonus has been included in income, thus conception of law has to change in order to suit exigencies of a situation.

In the Objects and Reasons, the following occurs:

> The Privy Council in Shaw Wallace case - 6 I T C 178) has ruled that capital sums received in commutation of pension or as consolidated compensation for death or injuries or in payment of an insurance policy or as the accumulated balance from a Government Provident Fund could not in any scheme of taxation be regarded as income. Specific exemption therefore is superfluous and the provision is deleted

The above statement does not seem to be quite correct. It is true that this view has been expressed by the Judicial Committee but it is not a ruling it is by way of obiter dictum. It is, therefore, not so forceful as is made to appear. The statement of objects and reasons given in the draft Income-tax Bill has also no legal force.

Besides, the very fact that such an exemption which was statutory up to March, 1939, had been deleted by the amendment Act of 1939 would probably be used, after a lapse of time, as a strong argument indicating the contrary view (*i.e.*, these are items of income). Where the

law does not give definite sanction, the question of intention will be of little avail. To understand this point of view, the following are of interest :—

In Balaji Rao *vs.* C.I.T., Madras, 1935, I.T.R. 461, it was decided that gratuity paid in a lump sum in lieu of pension was taxable.

In Partington *vs.* Attorney General (1869) Lord Caisus observed as follows :—

> "If the person sought to be taxed comes within the letters of the law he must be taxed however great the hardship may appear to the judicial mind to be. On the other hand, if the crown seeking to recover the tax, cannot bring the subject within the letter of law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible, in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute."

For an answer to item 12 (page 3) before 1. 4. 1939, section 4(3)(*v*) could have been referred to but with its deletion, the case of Shaw Wallace will be referred. It is admitted there that commuted pension and some other allied incomings are capital without the shadow of doubt.

(1) Pension monthly received is taxable.

(2) Commuted pension exempt from tax.

(3) Lump sum gratuities in lieu of pension are taxable (Balaji Rao's case).

(4) Gratuities received as gifts may be exempt.

(5) Accumulated balance includes not only contributions and subscriptions but also interest thereon.

Section 4(3)(vi). Any special allowance, benefit or perquisite specifically granted to meet expenses wholly and necessarily incurred in the performance of the duties of an office or employment of profit.

NOTE.—(1) Perquisite means "any casual emolument, fee or profit attached to an office or position in addition to salary or wages."

(2) Perquisite is taxable like salary, but the above "special allowance, benefit, perquisite, etc." are exempt if the two following conditions are satisfied :

(*a*) The allowance must be specifically granted to meet the extra expense thus caused to the employee and that extra expense only.

(*b*) The expense incurred by the employee must be wholly and necessarily incurred in the performance of his duties as an employee

It is thus a question of fact in each case whether house rent allowance or the value of rent free quarters is exempt from the tax, but the following examples will show the lines on which decision should be made :

(*a*) A currency officer is granted rent-free quarters in his currency office He will be liable to tax on the value of his rent-free quarters.

(*b*) A Government office has its headquarters in Bombay, but proceeds for some months in the year elsewhere and grants its ministerial establishment house rent allowances or rent free quarters in the place to which it proceeds with the specific object of providing for the maintenance of the second The allowance or value of rent-free quarters will be exempt

(*c*) In all cases where rent-free houses form part of the perquisites of an employee, the cash value of such a house to the occupier need not ordinarily be deemed to be more than 10 per-cent of the salary of the employee.

(*d*) The "Delhi moving allowance" and "Delhi camp allowance" are exempt.

(*e*) Officers and other ranks of the Army in India (British and Indian) are exempt from tax so far as the following allowances are concerned :—

Messing, syce, forage, meal money and clothing allowance, outfit allowance, horse allowance, tentage, travelling, etc.

Section 4(3)(vii). **Casual gains :**

Any receipts not being receipts arising from business or the exercise of a profession, vocation or occupation, which are of a casual and non-recurring nature, or are not by way of addition to the remuneration of an employee.

The following two conditions must be satisfied before any income or profits can be exempted as *casual* :

(1) they must not be the proceeds of a profession, vocation or employment, or arise from business, that is, from "any venture or concern in the nature of trade, commerce or manufacture," and

(2) they must not be annual.

Both these conditions must be fulfilled. The exemption also is specifically not to apply to any gratuity to an employee for services rendered so as to avoid the possibility of any ambiguity in connection with the use of the word "gratuity" in section 7(1). The following are illustrations of the effect of the provisions of section 4(3) (*vii*) :

(1) A purchases a house with a view to re-selling it at a profit. His profits from the transaction are liable to income-tax (even although it be an insolated transaction). B purchases a house for his own residence and later on sells it at a profit. His profit is not liable to the tax.

(2) A wins a prize in a lottery or a bet on the race-course. His receipts therefrom are not taxable. B is a bookmaker. His profits from betting are taxable.

(3) A is a professional beggar. His receipts from mendicancy are not exempted from the tax by this sub-section.

(4) A makes a practice of speculating in the purchase and sale of shares. His profits therefrom are liable to the tax. B purchases Indian War Loan 1929—1947 at 95 redeemable at par. The premium received on redemption after a period of years is not liable to the tax. On the other hand the yield from Treasury Bills arising from their issue at a discount and repayment at par ofter 12 months or some shorter period is liable to the tax under

section 12, though as this yield is not interest, the tax is not deducted at the source under section 18(3).

(5) A man writes a book. His receipts from its sale are taxable.

(6) Lump sum legacies are exempt; annuities granted under a will are not exempt." (I.T.M.)

For an answer to items 9, 10, 11 (pp. 2, 3) it should be referred to casual income They are not taxable

In C.I.T. Burma *vs* J. I. Milne, 1934, I.T.R. 25, the case was as follows:—

In consideration of a sum of Rs 10,000 advanced by the assessee to a mining engineer for working certain mines the latter promised to pay the assessee in the event of the mines being sold, a sum equal to one-third of the total consideration which he might receive by the sale of all the mining areas held by him The mines were sold and under this agreement the assessee received £6,000 in cash and shares of the face value of £9,000 Income-tax was claimed from the assessee on the amount of £ 6,000. Held, that £ 6,000 which had accrued to the assessee did not form part of the profits or gains of any business carried on by the assessee within section 10 of the Income-Tax Act, nor was it profits or gains 'derived from other sources' within section 12, it was a receipt, not being a receipt arising from business, of a casual and non-recurring nature within section 4(3)(vii) of the Income-Tax Act, and as such not assessable to income-tax.

Held, further, that the fee of Rs 100, which must accompany an application for reference under section 66(2), Income-Tax Act, forms part of the costs of, and incidental to, the reference, which the court in its discretion may award in a proper case to the assessee

When an employee is about to get a gratuity, he should see that he gets it as a gift, as a token of gratitude or merit (not past services) in which case, it should be regarded as a casual gain.

Section 4(3) (viii). Agricultural income.

This has been discussed in Section 2

Section 4(3) (ix). Any income received by trustees on behalf of a recognised Provident Fund.

Note:—

(1) Definition of "Recognised Provident Fund" is given in section 58A, etc.

4A. For the purposes of this Act—

(a) any individual is resident in British in any year if he—

(i) is in British India in that year for a period amounting in all to one hundred and eighty-two days or more; or

(ii) maintains or has maintained for him a dwelling place in British India for a period or periods amounting in all to one hundred and eighty-two days or more in that year, and is in British India for any time in that year; or

(iii) having within the four years preceding that year been in British India for a period of or for pericds amounting in all to three hundred and sixty-five days or more, is in British India for any time in that year otherwise than on an occasional or casual visit;

(b) a Hindu undivided family, firm or other association of persons is resident in British India unless the control and management of its affairs is situated wholly without British India; and ...

(c) a company is resident ih British India in any year (a) if the control and management of its affairs is situated wholly in British India in that year, or (b) if its income arising in British India in that year exceeds its income arising without British India in that year.

4B. For the purposes of this Act—

(a) an individual is ' not ordinarily resident ' in British India in any year if he has not been resident in British India in nine out of ten years preceding that year or if he has not during the seven years preceding that year been in British India for a period of, or for periods amounting in all to, more than two years;

(b) a Hindu undivided family is deemed to be ordinarily resident in British India if its manager is ordinarily resident in British India;

(c) a company, firm or other association of persons is ordinarily resident in British India if it is resident in British India.

Control and Management.—The para 31 of the Report of the Royal Commission on the Income-tax in England of 1920 runs as follows:—

"Briefly it may be stated that a company, wherever it may be incorporated, is deemed to reside at the place from which the effective control of its operations is exercised. Where its seat of control is within the U K the company, in the same way as any other British Resident, is liable to be assessed to income-tax on the profits of the whole of its trading operations, whether they are carried on within the U K or elsewhere."

In the case of joint stock companies incorporated in England, though it may be shown in many cases that management is in India, still, the broad fact cannot be ignored that the control lies in U.K., because, the shareholders meet in the Annual General meeting in U K., for final disposal of all important matters of administration and policies.

Definitions:

(1) An **individual is Resident** in British India,

(a) if he is in British India in *that year* for 182 days or more, or

(b) if he maintains a house in British India for 182 days or more and is in British India for any time in *that year*; or

(c) if he is in British India for 365 days or more within the four years preceding that year and is in British India for any time in *that year* (except on a casual visit)

NOTE.—(*i*) The assessee must in every case be in British India in the year of assessment.

(*ii*) Two conditions have to be satisfied in each of (*b*) and (*c*) above.

(*iii*) Occasional or casual visit will not bring the visitor within the mischief of (*c*) above.

(*iv*) **The expression 'any time' should be noted.**

(2) **A Hindu undivided family, Firm or other association of persons is resident** in British India unless the control and management of its affairs is situated *wholly* without British India.

NOTE.—(*i*) Any insignificant part of control exercised from within British India would decide that it is resident against any amount of control from outside British India. In other words, to prove against residence, one has to prove that there is no control from British India.

(*ii*) Thus the place of the karta of the family is very important.

(3) A **company is resident** in *any year*

(*a*) if the control is wholly in British India in that year, or

(*b*) if its income arising in British India exceeds its income arising without British India in that year.

NOTE.—(1) Residence to be determined from year to year.

(2) Unlike Hindu undivided family or firm, etc., any insignificant control or nominal management from outside British India (say, from native states or England) would bring the company out of the clutches of this section and thus make it "non resident."

This confers a distinct advantage to a large number of companies (Tea companies, Banking companies, Insurance companies, Mercantile houses incorporated in England where generally lies the nominal or some control) so as to put them beyond the mischief of the definition of 'Resident'.

For the purpose of taxation of a company it does not seem very reasonable why the control and management should be the only factor determining residence and not the place where business is carried on.

4B Definition of "**Not-ordinarily Resident**".

(1) If an individual has not been resident in British India in 9 out of 10 years preceding that year, or

(2) If he has not during the 7 years preceding that year been in British India for a period of or for periods amounting in all to, more than 2 years.

NOTE.--(a) First part relates to conditions of residence. Each financial year is considered separately; odd periods will not be aggregated

(*b*) Second part relates to his physical presence Odd periods will be aggregated to see whether the total comes to 24 months.

Referring to (*a*), minimum period of stay every year for residence purposes is 6 months or more. Hence to avoid being resident an assessee is to stay every year, say, just a little less than 6 months. So his total period of stay may be, at the maximum, just a little less than 4½ years Likewise, the other conditions of residence

Referring to (*b*), his physical presence not amounting to 2 years during the last 7 years He may be technically resident for a number of years even all the 9 years still, if he can prove that during the last 7 years he is physically present for not more than 2 years, he will be regarded 'not ordinarily resident.'

Now to discuss the positive form, *viz.*, ordinary residence, the two alternative conditions will, by ordinary rules of logic, be cumulative; that is, both the conditions of residence and physical presence have to be satisfied.

Suppose an Indian trader doing business in South Africa comes to his ancestral house every year for a month, he may have technically become resident every year and for 9 years, still, he will not be ordinarily resident until he can prove that he has also been in British India for over 2 years during the last 7 years.

Conversely, if another trader can show that he has been in British India for more than 2 years during the last 7 years he will be ordinarily resident if can also prove that he has been a resident (according to 4-A) for 9 years out of the preceding 10 years.

It may be repeated here that to prove an individual "not ordinarily resident," *one* of the *two* conditions has got to be fulfilled. It is only when an individual is to get the status of "ordinarily resident" that *the two* conditions must be at once satisfied.

Regarding the sweep of assessment, it will be immensely more advantageous if the whole scheme is first put in its bare minimum shorn of legal complexities. The three classes are as follows :—

(1) Non resident,

(2) Resident and not-ordirarily-resident,

(3) Resident and ordinarily-resident.

(1) A **non-resident** will be charged

on all income arising or received in British Irdia.

(He will have to pay no tax on his income arising outside British India irrespective of whether any portion of his income abroad is brought into British India or not).

(2) A **resident, who is at the same time not-ordinarily-resident,** will be charged

(*a*) on the same income as a non-resident (above), *plus*.

(*b*) on any income arising abroad from his business controlled in India (including Indian States), *plus*

(*c*) on any income arising outside British India if it is brought into British India.

(3) A **resident who is also ordinarily-resident will be** charged

(*a*) on the same income as a resident and not-ordinarily-resident (above), *plus*

(*b*) on any income arising outside British India which is not brought into British India after allowing a deduction of Rs. 4,500.

A Resident therefore pays:—

(*a*) on income arising or received in British India,

(*b*) on income arising abroad from his business controlled in India (including States),

(*c*) on income arising outside British India if it is brought in British India,

(*d*) on income arising outside British India which is not brought into British India with a deduction of Rs. 4,500.

NOTE.—(1) For the basis of calculating the tax, the non-residents are divided into two classes as per section 17:—

(*a*) British Subjects,

(*b*) All others.

(2) For 1940-41 assessment, tax will be levied on the greater of the two following:—

(*a*) All other income arising outside British India in the previous year even though it is not brought into British India;

(*b*) All amounts brought into British India during the previous year out of income which accrued before the beginning of such year and after 1st April, 1933.

Section 5.

Income-tax authorities are the following:—

(1) Central Board of Revenue.

(2) Appellate Tribunal.

(3) Commissioners of income-tax.

(4) Assistant Commissioners of income-tax.

(*a*) Appellate Assistant Commissioner.

(*b*) Inspecting Assistant Commissioner.

(5) Income-tax officers.

(1) The Central Board of Revenue is appointed by the Central Government This Board frames rules and instructions in interpretation of the provisions of the Act and is entrusted with the general administration.

(2) See 5-A. (New section which will come into force before 1 4. 41). *Vide* Appendix.

(3) Commissioner of income-tax is the head of the Income-tax Department in a province. He is appointed by the Governor-General in-Council.

Special Commissioners:—

Over and above the Commissioners appointed for local areas, the Central Government may appoint not more than 3 Commissioners to do special kind of work without any reference to area. The work will be mainly co-ordinating any other special and important cases.

(4) Assistant Commissioners and Income-tax Officers are appointed and dismissed by the Central Board of

Revenue. Assistant Commissioners and Income-tax Officers have the right of appeal to Governor-General-in-Council.

Appellate Assistant Commissioners whose main duty is to hear appeals are placed directly under the control of the Central Board of Revenue but this does not mean that the C. B. R. has any power to issue instructions about appellate functions. For day to day administration, however, it seems they are under the Commissioner. The position of the Commissioner in relation to the appellate Assistant Commissioner seems somewhat unsatisfactory.

Inspecting Assistant Commissioner's duty is executive and will work under the direction of the Commissioner All others are under the Commissioner.

(5) Income tax Officer's main duty is to make assessment within a specified territorial limit They are in immediate control of the office and are responsible to the Inspecting Assistant Commissioners

Section 5-A. (See Appendix).

Mr. Chamlers said in the Council of State :- -

"The intention is to have appeals heard by Benches of two members drawn from the tribunal which would be a kind of panel and one judicial member would sit with one accountancy member, so that when a case came up which dealt with difficult points of accountancy or of business generally, the experience and knowledge of the accountancy member would be available, while of course, on points of law there would be the experience and learning of the judicial member. Provision is made for referring to the President of the Tribunal of any case in which there is a difference between two members hearing an appeal and the President can then refer the matter to other members and take a majority decision. The precise rules for determining the manner in which that should be done have not been laid down · they have been left for the President to make himself. Now, one big difficulty which was feared when these proposals were first mooted was that there

will be hundreds and thousands of appeals, some of them very small, which would go from the Assistant Commissioner to the Appellate Tribunal. I may say at this stage that the intention is that the various Benches should sit at the same time in different parts of India, so that one will be sitting in Bombay, one in Calcutta and perhaps another in Madras. Thus, in various parts of the country these groups of two would be hearing appeals at the same time. It was felt that the Tribunal would be flooded out by these appeals and that something must be done to prevent that, otherwise the increase in the number of members necessary to hear the appeals would be so great as to make the scheme altogether too costly. To get over that, the proposal is to provide for a fee of Rs. 100 for every appeal to be taken to the Tribunal. The assessee continues, of course, to have the right without any cost of going to the Assistant Commissioner, who in future will do nothing but hear the appeals and it is expected that he will be able to do substantial justice in all ordinary simple cases. That will mean that only those cases in which a very large point of substance or a very difficult point of law arises will, in fact, go to the Appellate Tribunal. That corresponds very largely, almost exactly, to the system of the Special Commissioners in the United Kingdom. There, the special Commissioners are a full-time body as here and they go on tours in towns all over the country and it is a practice for only fairly large and important cases to reach that stage. I think I have explained everything that need be explained on that Tribunal except possibly this that the Tribunal will not in any sense be under the control of the Commissioner as it is going to be an entirely separate judicial body and for that reason the right is given to the Income-tax Officer himself to lodge an appeal against the decision of either the present Assistant Commissioner or the Appellate Tribunal. His appeal against the Appellate Assistant Commissioner's decision would, of course, be on the instructions of his Commissioner of Income-tax and and would follow the same course as that of an appeal by an assessee. The further stage will, of course, be nothing more than the reference to the High Court on a point of law in the same way as a point of law can now be referred by the Commissioner to the High Court. I think that is all I need say about the Appellate Tribunal."

For other particulars, see "General Hints to Assessees" towards the end of the book.

Sec. 6. Save as otherwise provided by this Act, the following heads of income, profits and gains, shall be chargeable to income-tax in the manner hereinafter appearing, namely:—

(i) Salaries.

(ii) Interest on securities.

(iii) Income from property.

(iv) Profits and gains of business, profession or vocation.

(v) Income from other sources.

As sources of income are different in character, it is necessary to have some groupings. The process of arriving at the assessable income in each case is different because deductible allowances have naturally to be and actually are different in kind. Moreover, the bases of assessment are of necessity different and income from one source may bear deduction at source, whereas the income from another may not bear that deduction at source but taxed after the assessee has received them.

Sec. 7. (1) The tax shall be payable by an assessee under the head "Salaries" in respect of any salary or wages, any annuity, pension or gratuity, and any fees, commissions, perquisites or profits in lieu of, or in addition to, any salary or wages, which are due to him from, whether paid or not, or are paid by or on behalf of, the Crown, a local authority, a company, or any other public body or association, or any private employer; and for the purposes of this sub-section advances by way of loan or otherwise of income chargeable under this head shall be deemed to be salary due on the date when the advance is received;

Provided that the tax shall not be payable in respect of any sum which the assessee by the conditions of his employment is required to spend out of his remuneration wholly, necessarily and exclusively in the performance of his duties;

Provided further that the tax shall not be payable in respect of any sum deducted from the salary payable by or on behalf of the Crown to any individual, being a sum deducted in accordance with the conditions of his service, for the purpose of securing to him a deferred annuity or of making provision for his wife or children, provided that, the sum so deducted shall not exceed one-sixth of the salary;

Provided further that where tax is deductible at the source under section 18, the assessee shall not be called upon to pay the tax himself unless he has received the salary without such deduction;

Explanation 1.—The right of a person to occupy free of rent as a place of residence any premises provided by his employer is a perquisite for the purposes of this sub-section.

Explanation 2.—A payment due to or received by an assessee from an employer or former employer or from a provident or other fund at or in connection with the termination of his employment, whether or not the employment is then terminated or to be terminated, is to the extent to which it does not consist of contributions by the assessee or interest on such contributions a profit received in lieu of salary for the purposes of this sub-section, unless the payment is made solely as compensation for loss of employment and not by way of remuneration for past services:

Provided that nothing herein contained shall render liable to income-tax any payment from a provident fund to which the Provident Funds Act, 1925, applies, or any payment from a recognised provident fund within the meaning of Chapter IXA if such payment is exempted from payment of income-tax under the provisions of Chapter IXA, or any payment from an approved superannuation fund within the meaning of Chapter IXB made on the death of a beneficiary or in lieu of or in commutation of an annuity, or by way of refund of contributions on the death of a beneficiary or on his leaving the employment in connection with which the fund is established.

(2) Any income which would be chargeable under this head if paid in British India shall be deemed to be so chargeable if paid to a British subject or any servant of His Majesty in any part of India by or on behalf of the Crown or by a local authority established in the exercise of the powers of the Crown Representative or the Central Government in that behalf.

Section 7(1).

NOTE.—(1) Salary includes amounts paid and amounts due which remained unpaid in the previous year, and also any extra amount actually paid unless it has been assessed in an earlier year.

(2) Advance of salary is deemed to be salary due on the date when the advance is received.

(3) I.T. and S. T. are deductible under section 18(2) on the amount actually paid; any amount escaping will be directly assessed on the employee.

(4) Tax is not payable on allowance which the assessee is required to spend by the conditions of his employment *wholly, necessarily* and *exclusively* in the performance of his duties. Horse allowance, Cycle allowance or even Motor Car allowance will be covered by this.

(5) By explanation 1, a rent free house provided by employer is a perquisite and hence assessable.

(6) By explanation 2, the following are to be taxed :—

Lump sum payments (other than payments made solely as compensation for loss of employment) received by an employee from an employer or former employer or from provident funds (which are neither provident funds under Provident Funds Act of 1925 nor under recognised provident funds) whether or not the employment is terminated or is to be terminated.

This provision makes inoperative the Privy Council decision in the case of B. J. Fletcher, 1937. I T R 428.

(7) But the following are not to be taxed :—

(1) Any payment from a Provident Fund to which P/F Act 1925 applies.

(2) Any payment from a recognised Provident Fund (chapter IX-A).

(3) Any payment from an approved superannuation fund (Chapter IXB) made :

(*a*) on the death of a beneficiary,

or (*b*) in lieu of or in commutation of an annuity,

or (*c*) by way of refund of contributions on the death of a beneficiary,

(*d*) **on his leaving the employment.**

Section 7(2).

"This sub-section, i.e., Section 7(2) makes chargeable, under this head, salaries paid from Indian revenues to Government employees in any part of India, and salaries paid by a local authority established in exercise of the power of the Governor-General in Council. All servants of Government or of such local authorities are, therefore, liable to pay tax on their salaries if they are employed in any part of India, and irrespective of their nationality". [I.T.M., Para. 37(*i*)].

Abatement under section 7(1) Proviso and under section 15(1).

Section 7(1). Proviso:

Amount deducted from one's salary, under the authority and with the permission of the Government for the purpose of securing a deferred annuity to him or making provision for his wife and children.

Section 15(1).

Amount paid by one to an insurance company in respect of an insurance or deferred annuity on his own life or on the life of his wife.

Amount paid by him as a contribution to any of the Provident Funds (under Provident Funds Act 1897 now Act XIX of 1925 and also under Provident Insurance Societies Act of 1912).

Provided the total abatement claimed does not exceed one-sixth of the total income and this $\frac{1}{6}$th must not exceed Rs. 6,000 in the case of an individual and Rs. 12,000 in the case of a H. U. F.

NOTE.—The abatement does not apply to super-tax, *i.e.*, super-tax is levied on the total income undiminished by any abatements.

Section 7(1) Proviso and section 15(1).

A little confusion may arise as to the necessity of section 7(1) Proviso when there is the more comprehensive section 15(1) which includes not only

(1) insurance on his own life or on the life of his wife, and

(2) contract for a deferred annuity, on his own life or on the life of his wife; but also

(3) contribution to any Provident Fund to which the Provident Funds Act 1897 applies or to any Provident Fund which complies with the provision of the Provident Insurance Societies Act 1912.

The proviso to section 7(1) is meant to serve another purpose. While section 15 deals with insurance and provident fund deductions, the proviso to section 7(1) refers only to compulsory deductions made under the authority of the Government, not of other employers and such compulsory deduction must not exceed $\frac{1}{8}$ of the salary

Illustration 32.

The salary of Professor Gurcharan Lal of the Lucknow University is Rs. 1,200 p.m. 8% on his pay is deducted for his Provident Fund (semi-Government Provident Fund, which comes under Act XIX of 1925). Find out the net sum payable to Mr. Lal per month and his liability to income-tax.

Solution.

Gross salary	Provident Fund deduction.	Income-tax deducted.
Rs. 1,200 × 12 = Rs. 14,400	8% being Rs. 96 p. m.	Rs. 92-1-0 Monthly.
	96 × 12 = Rs. 1,152	Rs. 1,104-12-0 yearly.

Total income of Mr. Lal :—

(1) Salary ...	...	Rs. 14,400
(2) Examination fees	...	nil
(3) Interest on securities	...	nil
(4) House property	...	nil
Total Income	...	Rs. 14,400

Therefore average rate is 14·73 pies.

Less Provident Fund Rs. 1,152 at 14·73 = Rs. 88-6-0 (refundable to Mr. Lal).

The monthly net salary receivable by Mr. Lal :—

		Rs.	a.	p.
Salary ...	...	1,200	0	0
Less Provident Fund	...	96	0	0
		1,104	0	0
Less Income-tax	...	92	1	0
		1,011	15	0

If Mr. Lal desires that his provident fund refunds should be adjusted against his monthly salary then he will get monthly ... Rs. 1,011 15 0

Add ... Rs. 7 5 10

Rs. 1,019 4 10

NOTE.—In Banke Behari Lal *vs.* Commissioner of Income-tax, Punjab, 1937 I.T.R.345, the Lahore High Court decided that the salaries actually received during the year would be taxed. Salary due but left undrawn until 1st April, would not be taxed.

The new Amendment has made it impossible.

Illustration 33.

Assuming Mr. Lal has the additional following incomes :—

		Rs
Examination Fees	... ...	1,500
Interest from Bank deposit	...	4,500
Rent from house property (let out)	...	2,100

His life insurance premiums are Rs. 160 per month.

Solution.

STATEMENT OF TOTAL INCOME.

Particulars			Gross Income. Rs.	a.	p.	Tax deducted. Rs.	a.	p.
(1) Salary	.. .. ..		14,400	0	0	1,104	12	0
(2) Examination fee	.. ..		1,500	0	0			
(3) Bank interest ..	. ...		4,500	0	0			
(4) House property :		Rs.						
Rents	.. ...	2,100						
Less 1/6 for repairs	...	350						
		——	1,750	0	0			
Total Income	...		22 150	0	0	1,104	12	0
Average rate @ 19·91 pies.								
Tax on total Income of Rs. 22,150 @ 19·91 pies.			2,296	14	0			
Less L. I. P. 1,920 ... P/F 1,152 ...		@ 19·91	318	9	0			
—— 3,072			——			1,978	5	0
						873	9	0
						Payable.		

For an income of Rs. 16,200 (monthly salary being Rs. 1,350)

on the first Rs. 1,500	...	nil		
on the next Rs. 3,500 at 9 pies	...	Rs. 164	1	0
Rs. 5,000 at 15 pies	...	Rs. 390	10	0
Rs. 5,000 at 24 pies	...	Rs. 625	0	0
Rs. 1,200 at 30 pies	...	Rs. 187	8	0
		Rs. 1,367	3	0

Monthly tax is Rs. 113-15-0 being $\frac{1}{12}$ of Rs. 1,367-3-0.

The average rate of income-tax per rupee of income comes to $\frac{\text{Rs. } 1367-3}{16,200}$ or 16·20 pies. This is the rate at which rebate for life Insurance or provident fund payments, etc. (or share from an unregistered firm or association of persons, etc.) is to be allowed, whether the rebate is given each month, or wholly from one deduction or by refund at the end of the year. The average rate of I.T. on the whole income determines the rate at which refund or rebate is to be given on dividends or interest on securities, the rebate being given at the difference between the maximum rate (or the rate at which tax has been suffered) and the average rate.

Super tax, when leviable, is calculated at the rate laid down in the Finance Act. This is (in addition to I.T.) also deductible monthly from salaries. No rebate for Life Insurance, etc., is allowable in computing Super-tax.

	Rs.	
S. T. rate on 1st	25,000	nil.
next	10,000	1 anna.
,,	20,000	2 annas.
,,	70,000	3 annas.
,,	75,000	4 annas.
,,	1,50,000	5 annas.
,,	1,50,000	6 annas.
on Balance		7 annas.

Provident Fund

For income-tax purposes provident funds can be of three classes:

(1) Provident Funds Act 1897 (XIX of 1925 as now known).

(2) Recognised Provident Fund (Chapter IX-A of the Income Tax Act).

(3) Private Provident Fund (*i.e.*, unrecognised).

Under Class (1), *i.e.*, Provident Funds Act of 1925 there are:

(*a*) List of Institutions approved under Section 8(2) of the P/F Act of 1925:--

1. The Pasteur Institute of India, Kasauli.
2. The Calcutta Improvement Tribunal.
3. A Court of Wards.
4. The Indian Central Cotton Committee.
5. The Trustees for the European Hospital for Mental Diseases at Ranchi.
6. The National Association for supplying female medical aid to the women of India.
7. A College affiliated to a University established by Statute.
8. The Indian Coal Grading Board.
9. The Lady Minto's Indian Nursing Association.
10. The Indian Red Cross Society.
11. The Indian Lac Cess Committee.
12. The Madras Provincial Branch of the Indian Red Cross Society.
13. The Imperial Bank of India.
14. The Bihar and Orissa Medical Examination Board.
15. The Punjab University.
16. The Institute created for the control of emigrant labour under the Tea Districts Emigrant Labour Act, 1932.

17. The Bombay Board of Film Censors.
18. The Calcutta University.
19. The Central Board of Irrigation.
20. The Reserve Bank of India.
21. The Trustees of the Victoria Memorial Park, Rangoon.
22. The Benares Hindu University.
23. The Medical Council of India.
24. The Indian Coffee Cess Committee.

(*b*) Government Provident Fund which runs as follows :—

"Government Provident Fund" means a Provident Fund, other than a Railway Provident Fund, constituted by the authority of the Secretary of State, the Central Government, the Crown Representative or any provincial Government for any class or classes of its employees or of persons employed in educational institutions or employed by bodies existing solely for educational purposes, and references in this Act to the Government shall be construed accordingly.

(*c*) Railway Provident Fund which runs as follows :—

"Railway Provident Fund" means a Provident Fund constituted by the authority of a railway administration for any class or classes of its employees

"Railway administration" means—

(*i*) any company administering a railway or tramway in British India either under a special Act of Parliament or an Indian law, or under contract with the Crown, or

(*ii*) the manager of any railway or tramway administered by the Federal Railway Authority or by a Provincial Government,

and includes, in any case referred to in sub-clause (*ii*), the Federal Railway Authority or the Provincial Government, as the case may be.

Contribution by Employer and Employee (P/F Act, 1925)

(*a*) The accumulated balance at the credit of a subscriber is exempt from both income-tax and super-tax.

(*b*) Employee's contribution is free from income tax in the yearly assessments.

(*c*) Employee's contribution is not free from Super-tax in the yearly assessment, for, super-tax is levied on the total income without any deductions

Under Class (2):—Contribution by an employee is exempt from income-tax (not super-tax).

Contribution by an employer exempt in the hands of the recipient from income-tax, but enters into total income to augment the rate (not exempt from super tax)

Contribution by employer is allowed as a business expense in his profit and loss account

NOTE - Conditions for recognition should be noted as in Chapter IX-A of the Act.

Under Class (3), *i.e.*, unrecognised or private provident funds,

(*a*) in case of irrevocable Trust, the whole of the income earned on or after 1. 4. 39 inclusive of interest on both employee's and employer's contributions should be income taxed and super-taxed.

In this case section 41 will apply. Where, in respect of income of the fund, the member's shares are indeterminate section 41—1st proviso will apply and tax payable at the maximum rate.

Contributions by employer are allowed as a business expense. In some cases, the employer charges the entire amount of his contributions as business expense at the time of actual payment. This charge is allowed. This amount is then taxed at the hands of the recipient.

Contribution by employee per month is not allowed as a deduction from total income or in other words, his own contribution is taxed monthly. Hence at the time of actual receipt of Provident Fund Account, his own contribution must be eliminated from the assessee's total income.

(b) in the case of revocable Trust, the account is to be regarded as a Fund belonging to the employer.

Superannuation Fund.

Mr. Bhulabhai J Desai.—There is another type of fund which is more common in the United Kingdom and that is what is called superannuation fund. This is collected more or less on the same basis, but instead of being paid out in lump, a man on retirement gets an annuity or pension for his life. It is different from the Provident Fund only in this sense, that whereas in the latter case a man gets immediately a lump sum, in the case of the annuity the fund continues to pay it annually throughout his lifetime. Undoubtedly in the latter case the burden is a little more uneven dependent on the longevity of the individual, but that is purely a matter of internal adjustment of a system of mutual internal arrangement between the employees *inter se* and also the employer to the extent of the latter's contribution. To the provisions by way of exemption in the case of Provident Funds it is intended now to add also a similar provision with reference to superannuation funds.

Mr. S P. Chambers.—Now, the only other change of importance in relation to incidence of taxation is the granting of exemption to certain superannuation funds. Under the old Act, provident funds which conformed to certain rules were treated in a special manner. Their own income was exempt and the contributions by the employee were deducted and contributions by the employer were also deducted in arriving at his income. There were no corresponding provision for superannuation funds and a

new chapter has been introduced to give corresponding relief to superannuation funds. Although this clause introduces an entirely new Chapter, I think there is nothing controversial in it and I do not think I need say any more about it.

Sec. 8. The tax shall be payable by an assessee under the head "interest on securities" in respect of the interest receivable by him on any security of the Central Government or of a Provincial Government or on debentures or other securities for money issued by or on behalf of a local authority or a company:

Provided that no income-tax shall be payable under this section by the assessee in respect of any sum deducted from such interest by way of commission by a banker realizing such interest on behalf of the assessee or in respect of any interest payable on money borrowed for the purpose of investment in the securities by the assessee except interest chargeable under this Act which is payable without British India, not being interest on a loan issued for public subscription before the 1st day of April, 1938, unless in respect of interest which is so chargeable tax has been paid or deducted under section 18, or unless there is a person in British India who may be appointed an agent under section 43 in respect of such interest;

Provided further that no income-tax shall be payable on the interest receivable on any security of the Central Government issued or declared to be income-tax free;

Provided further that the income-tax payable on the interest receivable on any security of a Provincial Government issued income-tax free shall be payable by the Provincial Government.

Interest on securities

The interest chargeable under this section is the interest only on securities of the Government of India or of a local Government or on debentures or other securities for money issued by or on behalf of a local authority or company (debentures issued by associations, firms, clubs, etc., do not come under this—they come under section 12).

NOTE.—(1) If any direct expenses are incurred for earning the interest (*e.g.*, a man borrows a certain sum to purchase securities, the interest on the borrowed money

should be regarded as expense) such expenses are to be deducted from the gross amount of interest in order to bring it to assessable income.

(2) In connection with this source of income, tax is deducted at source at the maximum rate.

(3) Income under this head is assessable on the basis of actual receipt.

(4) The question frequently arises as to whether the profit from sale of securities is an accretion to capital or income. If the former, it is not taxable, but if it is the latter, it is taxable.

(5) It cannot be said that in every case, securities held by a bank are of the nature of the fixed capital.

In the case of Amritsar Produce Exchange, the Lahore High Court decided that the facts of every case have to be considered. It is upon the assessee to prove by documentary evidence or treatment in account-books or in other ways that his intention was to permanently set aside a sum from the floating capital in which case it would not be taxable, otherwise it will be taxable being regarded as income. (1937, I.T.R. 307.)

(6) An assessee deposited Government securities with a bank against an overdraft granted to him. He claimed deduction of interest payable to bank from interest receivable from securities. This was not allowed. (Mahadeo Ashram Prasad *vs.* C.I.T., Bihar, 1927, 2, I.T.C. 281).

(7) Where a business carrying on banking receives deposits or loans in the course of its trading activities, the interest on these deposits and loans will be allowed as a deduction from its entire income liable to tax without attempting at allocation of the borrowed money to investments in tax-free and other securities.

"When, however, there is a definite proof (not a mere inference) that a certain sum was specifically borrowed by a Bank or similar concern for the purpose of investment in tax-free securities and has been so invested, the interest on money so borrowed will be set off against the interest on the tax-free securities only. In

the case of Co-operative societies whose business income has been exempted from tax under section 60 of the Income-tax Act, a proportionate amount of interest will be allowed against the income from interest on taxed and tax-free securities. This interest will bear the same proportion to total interest paid as the capital invested in securities bears to the total working capital." (I.T.M., 8th Edition)

(8) (*a*) Interest on *sterling securities* of the Government of India or those issued by English companies carrying on business in British India would be chargeable when such interest is received by a holder of the security in British India.

(*b*) When a holder of such a sterling security is in U K , he is still chargeable though the *right to receive* is in U.K (before 1939, such income was not assessable.)

(*c*) When a holder of a security of the Government of India is in U. K. and receives the interest there, he is still liable to tax

(9) Income tax free securities are not free from Super-tax.

(10) The following are entirely exempted from the operation of the Act :

(*a*) Yield of Post Office cash certificates.

(*b*) Interest on deposit in the Post Office Savings Bank.

(*c*) Interest on Mysore Durbar Securities

(*d*) Interest on securities held by Provident Fund

(11) Super-tax with respect to this head is not deductible at source even if it exceeds the limit.

(12) Interest on income-tax-bearing Government Securities (up to a face value of Rs. 22,500) purchased through the post office and held in the custody of the Accountant General, Posts and Telegraphs, on account of any one assessee, shall be exempt from the tax but it shall

be included in the total income. This concession has been withdrawn in the case of all Savings Bank accounts with effect from 1st April, 1939.

(13) Interest on securities received by a Co-operative Society is not exempted from the tax. Such interest from its investments is not profits contemplated by Government notification. (The Madras Central Urban Bank, Ltd., *vs.* C.I.T., Madras, 1929. 3, I T.C , 357.)

(14) Net income under this head may be a negative quantity. Set off is allowed

(15) The only Government Securities (other than I.T. free securities) from the interest on which Income tax is not deducted are Treasury Bills.

(16) With respect to Government Securities:

(*a*) When they are held by an Indian State, the State is not assessable to Income-tax or Super tax except under the Government Trading Taxation Act 1926. *i e.*, unless the State carries on trade or business.

(*b*) When they are held by Ruling Princes or Chiefs as their private property, they are exempted by Section 60

(17) With respect to other Securities, *i e* , local authorities, Companies, etc.,

(*a*) Indian State is exempt.

(*b*) Ruling Princes not exempt.

(18) No income tax shall be paid on commission payable to a bank from interest earned on the security (*i.e* . bank commission deductible from interest on security).

(19) No income-tax shall be paid on interest payable on money borrowed for the purpose of investment in securities (*i e* , interest payable on money borrowed for the above purpose deductible from income from securities).

But if that interest is payable without British India (Loans issued before 1st April, 1938, are not affected by this), no deduction will be allowed unless in respect of such interest,

(*a*) Tax was already paid by the recipient; or

(*b*) Tax has been deducted under Section 18; or

(*c*) Recovery is possible from a person who is acting or who may be treated as an agent under Section 43.

Interest not chargeable under the Act has nothing to do with this section e.g., interest paid abroad in respect of a loan raised abroad which has been invested abroad and not brought into British India.

(20) The only current tax free security of the Central Government is 3 Loan, 1945 55.

Sec. 9. (1) The tax shall be payable by an assessee under the head "income from Property" in respect of the bona fide annual value of property consisting of any buildings or lands appurtenant thereto of which he is the owner, other than such portions of such property as he may occupy for the purposes of any business, profession or vocation carried on by him the profits of which are assessable to tax subject to the following allowances, namely:—

(i) where the property is in the occupation of the owner, or where it is let to a tenant and the owner has undertaken to bear the cost of repairs, a sum equal to one-sixth of such value;

(ii) where the property is in the occupation of a tenant who has undertaken to bear the cost of repairs, the difference between such value and the rent paid by the tenant up to but not exceeding one-sixth of such value;

(iii) the amount of any annual premium paid to insure the property against risk of damage or destruction;

(iv) where the property is subject to a mortgage or other capital charge, the amount of any interest on such mortgage or charge; where the property is subject to an annual charge not being a capital charge, the amount of such charge; where the property is

subject to a ground-rent, the amount of such ground rent; and where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital:

Provided that no allowance shall be made in respect of any interest or annual charge payable without British India and chargeable under this Act, not being interest on a loan issued for public subscription before the 1st day of April, 1938, except interest or a charge on which tax has been paid or from which tax has been deducted under section 18 or in respect of which there is an agent for the payee in British India who may be assessed under section 43;

(v) any sums paid on account of land revenue in respect of the property;

(vi) in respect of collection charges, a sum not exceeding the prescribed maximum;

(vii) in respect of vacancies, that part of the net annual value, after deducting the foregoing allowances, which is proportional to the period during which the property is wholly unoccupied or, where the property is let out in parts, that portion of the net annual value, after deducting the foregoing allowances appropriate to any vacant part, which is proportional to the period during which such part is wholly unoccupied;

(2) For the purposes of this section, the expression "annual value" shall be deemed to mean the sum for which the property might reasonably be expected to let from year to year:

Provided that, where the property is in the occupation of the owner for the purposes of his own residence, such sum shall, for the purposes of this section, be deemed not to exceed ten per cent. of the total income of the owner.

(3) Where property is owned by two or more persons and their respective shares are definite and ascertainable, such persons shall not in respect of such property be assessed as an association of persons, but the share of each such person in the income from the property as computed in accordance with this section shall be included in his total income.

Note.—(1) It is a section under which the owner of immovable property is assessed (C.I.T., Burma *vs.* Kaladan Suratee Bazar, 1920, I.T.C. 50).

(2) While the owner is assessable, "the mere existence of a dispute as to title, even where a suit has been filed, cannot itself hold up an assessment". (Keshardeo Chamaria *vs* C.I.T., Bengal, 1939, I.T.R. 394, P.C., affirming 1937 I.T.R. 246).

(3) "It may have the narrow and technical meaning of the full, ultimate and legal owner but if this was intended, it could easily have been expressed".

The above view *viz.*, ownership does not necessarily mean full and legal ownership was held in Burma Railways Co., *vs.* Secretary of State 1, I T.C.

(4) Whether owner should mean the legal owner or beneficial owner. In the case of C.I.T., Bombay, *vs* Abu Baker Abdul Rahaman 1939, I.T R. 139, the settlor conveyed his immovable property to Mutwallis or Trustees by a deed of wakf It was provided that after meeting the necessary expenses, the balance of income would be paid to the wife and children in certain proportions So long as children and remoter issues of the settlor remained, this payment would continue (this is called Wakf alal aulad). The Bombay High Court held that the trustees were not the "owners" of the trust properties and therefore not taxable under Section, 9.

(5) The Lahore High Court did not agree with the above views of the Bombay High Court and the Rangoon High Court, and Justice Dalip Singh of Lahore High Court observed :

"I agree that the word 'owner' is not defined in the Act and the word "owner" might very well cover the legal owner, the equitable owner or even the owner of a limited estate out of a larger estate. But from all this, it would not follow that the

incumbent of an impartible estate becomes for the purpose of Section 9, the owner of the property."

All that their Lordships of the Privy Council were there concerned with, was the question whether in a particular case, the word owner should mean the legal owner or the beneficial owner and whether a particular beneficiary could be said to be the owner (C.I.T., Punjab, *vs.* Dewan Krishan Kishore, 1939, I T.R. 427).

Annual Value:

The annual value as defined by Section 9(2) is a hypothetical sum and no deduction on account of municipal tax is allowed. Owner's share could certainly not be deducted (Krishna Lal Seal's case 1932, 6, I T.C. 293).

The Lahore High Court held the above view in Lalla Mal Sangham Lall (1936, I.T R. 250). By this decision, the Lahore High Court overruled the decision in Chuna Mal Saligram's case

(6) Tax shall be paid in respect of annual value of property consisting of any buildings or lands of which he is the owner. It is only the owner who is liable to pay tax under this head Where a person derives income from house property which he holds on lease, such income is chargeable under section 12. Lands not attached to a building are not chargeable under this section.

(7) The expression "annual value" means the sum for which the property might reasonably be expected to let from year to year. The annual value is a matter to be decided entirely by the Income-tax Officer. Still the value fixed by the local bodies for rating purposes is a very important factor for guidance, but it is not binding upon the Income-tax Officer. In fixing the annual value, the Income-tax Officer takes into consideration mainly the rents received from year to year.

The annual value mentioned here represents gross value. Where net value has been mentioned in property

tax bills, for assessment purposes, gross value has to be found out (net value is generally in big cities 90 per cent. of the gross).

Roughly the following allowances may be given to arrive at the basis of assessment :—

(1) Repairs not exceeding 1/6 of the gross value (obligatory).

(2) Insurance premium paid against fire, damage and destruction.

(3) If the property is subject to a mortgage or capital charge, interest payable on such mortgage or charge.

(4) Ground rent of property payable if subject to it.

(5) Any land revenue paid in respect of property.

(6) Collection charges actually paid not exceeding 6 per cent of the gross value

(7) Occasional vacancies should be taken into account.

(8) Interest payable on capital borrowed to acquire the property.

Owner's own residence under Section (9)2 proviso.

(8) Whereas the *bona fide* annual value alone forms the basis of assessment in the matter of house property (meant for letting), in the case of owner's own residence its assessable value is the annual value provided the amount does not exceed 10 per cent. of the total income of the assessee.

This proviso relieves the hard cases of those who have a big ancestral dwelling house without any substantial money income.

It is difficult to put an ordinary interpretation to this proviso, for, according to the proviso, the annual value which is only a part of the total income depends for its

ascertainment on the whole. When a part depends on the whole (the whole always depending upon the independent parts) a difficulty is inevitable. The only workable method would be to divide by 11 the income from all other sources (including house property let out). This will give the net annual value of the dwelling house.

Illustration 34.

Mr. K.'s monthly salary is Rs. 300. He received interest from War Loan securities Rs. 1,502 (gross). He has two houses: in one he resides, the annual value of which was estimated at Rs. 800, and the other is let out, the annual value being Rs. 900. Find out his total income.

Statement of Total Income.

1.	Salary Rs. 300 × 12	...	Rs. 3,600
2.	Interest on securities	...	Rs. 1,502
3.	House let out :—		
	Gross annual value ..	Rs. 900	
	*Less 1/6 for repairs	Rs 150	
			750
			Rs. 5,852
	1/11th of Rs. 5,852 is the net annual value of the dwelling house (net, *i.e.*, after 1/6th deducted)	...	Rs. 532
			Rs. 6,384 Total income.

Whether the net annual value comes to be Rs. 532 from the total income as per the Act can be tested :—

Total income Rs. 6,384.

According to the proviso, annual value must not exceed 10%, *i.e.*, ...	...	Rs. 638
Less 1/6th for repairs ...	...	Rs. 106
... ...	...	Rs. 532

*Gross annual value of the let out house less repairs should be included in the total income.

Illustration 35.

A man buys a house by borrowing Rs. 20,000 @ 6% p.a. interest. The annual value of the house is Rs. 1,000.

The assessee will be allowed to include in the total income loss of Rs. 200 arrived at as follows :—

Annual value	Rs. 1,000
Less charges thereon 6% on Rs. 20,000	Rs. 1,200
Loss	Rs. 200

In such a case, against the head 'property', will be included "— 200".

Illustration 36.

A owns 4 houses in one of which he lives The other three houses are let out and their annual value (as agreed to by Income-tax Officer) is fixed at Rs 6,000, Rs. 5,000 and Rs. 3,000 The annual value of the residential house is Rs. 1,600 as per municipal valuation The owner incurred the following expenses -

Fire insurance premium	Rs 125
Repairs	Rs. 3,200
Municipal taxes ..	Rs. 1,500
Land revenue	Rs 70
Collection charges	Rs. 1,200
Owner's life insurance premium ...	Rs. 2,400

Find out the total income of the assessee.

Solution.

Annual value of 3 houses let out ...	Rs. 6,000
	Rs. 5,000
	Rs. 3,000
	Rs. 14,000

Less deductions allowed :—

1/6 for repairs	...	Rs. 2,333	
Land revenue	...	Rs. 70	
Fire insurance premium	...	Rs 125	
Collection charges 6%	...	Rs. 840	
			Rs. 3,368
			Rs. 10.632
Add net annual value of the dwelling house being 1/11	...		Rs. 967
Total income	...		Rs. 11.599

NOTE. (1) Municipal taxes are not an allowable deduction.

(2) After calculating the tax on the total income, a relief has to be given on the amount of premium at the average rate of tax.

(3) Legal expenses incurred in recovering rents from tenants should be treated as a permissible deduction included in collection charges subject to the following conditions :—

(*a*) Only net legal expenses, that is, expenses after deducting any costs recovered from the opposite party will be deducted.

(*b*) The actual expenses incurred in excess of the costs deducted will be allowed in the year in which the decree is passed; a further allowance for costs proved to be irrecoverable will be given later, if necessary.

(*c*) The total allowance for collection charges including legal expenses allowed must, of course, not exceed the statutory 6 per cent.

(9) *Property: Deduction for unrealised rent.*—Unrealised rent on any property is exempt from income-tax

and is also excluded in computing the total income of an assessee, provided that—

(a) the tenancy is *bona-fide;*

(b) the defaulting tenant has vacated, or steps have been taken to compel him to vacate, the property;

(c) the defaulting tenant is not in occupation of other property of the assessee; and

(d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent.

(10) *Property in lots* —Section 9 does not contemplate assessment separately in respect of each building or any lot of buildings. Income should be computed on the whole of the assessee's property Consequently, allowance should be against the whole property of which he is the owner.

Illustration 37.

X's income from house properties for the year ending 31st December, 1929 is as follows —

Lot No. I.

Rent as per municipal assessment		Rs. 10,800
Expenses on above :—	Rs.	
Fire insurance premium	350	
Repairs etc .	1950	
Collection charges . .	250	
Interest on mortgage ...	900	

Lot No. II.

Rent as per municipal assessment		Rs. 4,860
Expenses on above :—	Rs.	
Fire insurance premium	150	
Repairs ...	... 1000	
Collection charges ...	350	

Ascertain the assessable income.

This illustration will show that allowances if given on the basis of separate lots of property will ultimately be different from what the total of allowances ought to be if the properties are combined and regarded as one item only.

Gross rents from properties		Rs.	
Lot I	... ...	12,000	
Lot II	... ...	5,400	
			Rs. 17,400
Less deductions allowed :--	Rs.		
Fire premium (350 + 150)	500		
Collection charges (250 + 350)	600		
Repairs	2 900		
Interest on mortgage	900		
			Rs. 4,900
Total income			Rs. 12.500

(11) A Company whose sole object is to acquire land, build house properties and earn rents therefrom is assessable under section 9 on such income. It will not be assessable under section 10. (Commercial Properties, Ltd., 1928, 3, I.T.C.).

In the matter of Commercial Properties, Ltd. (1928, A.I.R. 456) the assessee is a registered company whose sole object is to acquire land, build houses and let premises to tenants in Calcutta or elsewhere in India. The sole assets of the assessee's consist of three properties and the sole business of the assessee is the management, and collection of rents from the said properties.. ....

In the present case we have a company which owns three estates. It does not appear that any part of that property is outside the definition given in section 9. It is found to let the houses from time to time, to see to the payment of rents and (doubtless) the doing of repairs. If that is carrying on a business, then this

company carried on a business in the sense in which every landlord or owner of this type of property must necessarily carry on business."........."I entirely refuse my assent to the proposition that because it happens that the owner of a property is a company which has been incorporated for the purpose of owning such property, therefore, the income derived from "property" must be regarded as income derived from "business".

The cases to which we have been referred are cases in England with, I think, one exception which is a case from Burma. The case in Burma in re Kaladan Suratee Ba ar, Co., Ltd. arose out of the Excess Profits Duty Act, 1919. The Excess Profits Duty Act laid a special tax upon the profits of business, and although it contained a special protection for the earnings of a man in his profession there was no special provision applicable to the case of an owner of property. There was a company called the Kaladan Suratee Bazar, Co. Ltd., which owned certain plots of land and stalls at Moulmein at a bazar there. Its income was derived from the rents of houses and bazar stalls belonging to it, and the Financial Commissioner not disputing that it was subject to income-tax under Section 9, maintained that it was liable to excess profits duty because it was a "business" within the meaning of the Excess Profits Duty Act. The decision of the Court was that these two Acts were to be interpreted in the same way. It was pointed out that a person or a company drawing income from house property was clearly not contemplated in the Indian Income-tax Act, as carrying on a business but was treated as a person who derived income from the property; and in the same way, when the question of excess profits duty had to be decided the Court determined that the company was not carrying on a business within the meaning of that Act. It was pointed out that if the mere letting of stalls was carrying on a business within the meaning of the Act, then every person who had invested his capital in house property was liable to excess profits duty when his income rose above the minimum limit.

(12) Owner of a building need not be owner of the land on which building stands (C.I.T., Madras, *vs.* Madras Cricket Club, 1934, I.T.R. 209).

(13) In the matter of the Official Assignee for Bengal (1937, I.T.R., 233) a person was adjudged insolvent under

Presidency Towns Insolvency Act 1909 and his house properties vested in the Official Assignee. The Calcutta High Court decided that income from properties would come under taxation according to section 17 of the Presidency Towns Insolvency Act and Official Assignee was the owner of the property. Under Section 9 of the Insolvency Act the Official Assignee would be assessed as 'owner' of the property.

(14) The intention of the section is to tax the ultimate owner of the house property—the intermediate owners will be taxed under section 12.

(15) Annual value of the assessee's premises or that portion of the assessee's premises which he would use for business, profession or vocation is exempt from the tax. As a consequence, the annual value is not allowed as a deduction in the business accounts. Where tax is not chargeable (say club, etc.) the exemption is not given.

(16) **Where property is owned jointly. Sec. 9(3).**

Where property is owned jointly and the shares between the co-owners are definite and ascertainable, such persons will no longer be assessed as association of persons but share of each co-owner will be assessed as part of his total income.

Suppose, A and B are equal co-owners of a house property the income from which annually is Rs. 1,800 As association of persons, it will not be taxed being less than Rs. 2,000. According to the above sub-section A and B each will include Rs. 900 into his total income and pay tax on the whole personal income which will include this Rs. 900 also. Thus avoidance of tax is checked.

Suppose, A and B have no other income and the total income from the property is Rs. 3,600. As association though it is taxable, the application of this sub-section

means each will be exempt as each owner's share is less than Rs. 2,000.

(17) Occupier's tax deductible in arriving at the annual value :—

Illustration 38.

27, Hazratganj House

Gross Rental	...		Rs. 16,220
*Less occupier's tax	...		Rs. 1,220
Annual value.			Rs. 15,000
Less 1/6 for repairs	Rs 2,500		
,, Ground rent	Rs. 4,760		
,, Collection charge	Rs 850		
			Rs 8,110
Net annual value.			Rs. 6,890

(18) The assessee makes a claim for vacancy allowances before the I.T O. The method by which the amount of allowances can be ascertained is by

(1) drawing out the percentage that the allowances bear to the gross rentals, and

(2) ascertaining the gross rentals of the vacant rooms of the above house or for the vacant period of the entire house.

*Mr S. P. Chambers —" . . . In arriving at the annual value, these and other taxes which should fall upon the occupier but which are paid by the owner are deductible in arriving at the annual value."

In connection with a general (Municipal) rate which is not deductible, Mr. Chambers said.—"It is intended to be a tax charged on the basis of the annual value of the property and to fall upon the owner for the purpose of meeting the general expenditure of the Municipality, Improvement Trust. . . ."

Vacant periods have to be worked out and suppose the gross rental for the vacant period is Rs. 1,650. The claimable deductions according to the percentage worked out (Rs. 16,220 and Rs. 8,110 giving the percentage 50) is Rs. 825.

Therefore the assessable income is		Rs. 6,890
	Less ...	Rs. 825
		Rs. 6,065

Illustration 39.

A owns a large building in Bombay fetching a rent of Rs. 30,500 per annum. The net annual value of the property as per municipal assessment bills is Rs. 26,100. A wishes to have the following deductions made before arriving at the taxable income in respect of the above property :

(*a*) Rs. 5,000 for repairs during the year.

(*b*) Rs. 250 being fire insurance premium paid.

(*c*) Rs. 200 being the annual ground rent paid.

(*d*) Rs. 1,800 for collection charges paid.

(*e*) Rs. 1,500 being municipal taxes paid.

(*f*) Rs. 1,200 being interest on a mortgage.

(*g*) Rs. 500 being the rent of a portion of the house that was vacant during the year.

You are required to prepare a statement, showing the taxable income of A in respect of the above house property.

A's taxable income from business amounts to Rs. 53,625. He has insured his life and pays an annual premium of Rs. 15,600. He has received during the year dividends from joint-stock companies amounting to Rs. 8,700 declared free of tax and Rs. 2,900 declared less

tax. Determine the income-tax and super-tax (if any) payable by him.

Solution.

House Property :—

		Rs.	Rs.
Actual rent realised	...		30,500
Less 1/6 for repairs	...	5,083	
,, Fire Insurance	...	250	
,, Ground Rent	...	200	
,, Collection Charges	...	1,800	
,, Mortgage Interest	...	1,200	
,, Vacancy Allowance	...	500	
			9,033
			21,467

Illustration 40.

Statement of Total Income.

Particulars.		Gross Income. Rs.	a.	p.	Tax paid Rs.	a.	p.
(1) Income from Business		53,625	0	0			
(2) Income from House Property		21,467	0	0			
(3) Income from Securities :-							
(a) Tax-free Jt. Stock Divs.		10,311	2	0	1,611	2	0
(b) Less Tax Jt. Stock Divs.		3,437	0	0	537	0	0
Total Income	Rs.	88,840	2	0	2,148	2	0

Average rate $\frac{12,717}{88,840}$ = 27.5 pies

Tax due		Rs.	Rs.	a.	p.						
1st ..	.	1,500	Nil								
Next..	..	3,500	164	1	0						
Next..	..	5,000	390	10	0						
Next..	..	5,000	625	0	0						
Next...	...	73,840	11,537	8	0						
		88,840	12,717	3	0	12,717	3	0			
Less L. I. P. Rs. 6,000 @ 27·5 pies						850	6	0			
									11,857	13	0
						Still to pay			9,709	11	0

Super-Tax.

		Rs.					Rs. a. p.		
1st ...	...	25,000					Nil		
Next	...	10,000	@	0	1	0	625	0	0
"	...	20,000	@	0	2	0	2,500	0	0
"	...	33,840	@	0	3	0	6,345	0	0
		Payable				..	9,470	0	0

Sec. 10. (1) The tax shall be payable by an assessee under the head "Profits and gains of business, profession or vocation" in respect of the profit or gains of any business, profession or vocation carried on by him.

(2) Such profits or gains shall be computed after making the following allowances, namely:—

(i) any rent paid for the premises in which such business, profession or vocation is carried on, provided that when any substantial part of the premises is used as a dwelling-house by the assessee, the allowance under this clause shall be such sum as the Income-tax Officer may determine having regard to the proportional annual value of the part so used;

(ii) in respect of repairs, where the assessee is the tenant only of the premises, and has undertaken to bear the the cost of such repairs, the amount paid on account thereof, provided that, if any substantial part of the premises is used by the assessee as a dwelling-house, a proportional part only of such amount shall be allowed;

(iii) in respect of capital borrowed for the purposes of the business, profession or vocation the amount of the interest paid;

Provided that no allowance shall be made under this clause in any case for any interest chargeable under this Act which is payable without British India, not being interest on a loan issued for public subscription before the 1st day of April, 1938, except interest on which tax has been paid or from which tax has been deducted under section 18 or in respect of which there is an agent in British India who may be assessed under section 43 or, in the case of a firm, for any interest paid to a partner of the firm;

Explanation.—Recurring subscriptions paid periodically by shareholders or subscribers in such Mutual Benefit Societies as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause:

(iv) in respect of insurance against risk of damage or destruction of buildings, machinery, plant, furniture, stocks or stores, used for the purposes of the business, profession or vocation, the amount of any premium paid;

(v) in respect of current repairs to such buildings, machinery, plant, or furniture, the amount paid on account thereof;

(vi) in respect of depreciation of such buildings, machinery, plant, or furniture being the property of the assessee, a sum equivalent to such percentage on the written down value thereof to the assessee as may in any case or class of cases be prescribed:

Provided that –

(a) the prescribed particulars have been duly furnished;

(b) where full effect cannot be given to any such allowance in any year owing to there being no profits or gains chargeable for that year, or owing to the profits or gains chargeable being less than the allowance, the allowance or part of the allowance to which effect has not been given, as the case may be, shall be added to the amount of the allowance for depreciation for the following year and deemed to be part of that allowance, or if there is no such allowance for that year, be deemed to be the allowance for that year, and so on for succeeding years; and

(c) the aggregate of all such allowances made under this Act or any Act repealed hereby, or under the Indian Income-tax Act, 1886, shall, in no case, exceed the original cost to the assessee of the buildings, machinery, plant, or furniture, as the case may be;

(vii) in respect of any machinery, or plant which has been sold or discarded, the amount by which the written down value of the machinery or plant exceeds the amount for which the machinery or plant is actually sold or its scrap value: Provided that such amount is actually written off in the books of the assessee;

Provided further that where the amount for which any such machinery or plant is sold exceeds the written down value, the excess shall be deemed to be profits of the previous year in which the sale took place;

(viii) in respect of animals which have been used for the purposes of the business, profession or vocation otherwise than as stock in trade and have died or become permanently useless for such purposes, the difference between the original cost to the assessee of the animals and the amount, if any, realised in respect of the carcasses or animals;

(ix) any sums paid on account of land-revenue, local rates or municipal taxes in respect of such part of the premises as is used for the purposes of the business, profession or vocation;

(x) any sum paid to an employee as bonus or commission for services rendered, where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission:

Provided that the amount of the bonus or commission is of a reasonable amount with reference to—

(a) the pay of the employee and the conditions of his service;

(b) the profits of the business, profession or vocation for the year in question; and

(c) the general practice in similar businesses, professions or vocations;

(xi) when the assessee's accounts in respect of any part of his business, profession or vocation are not kept on the cash basis, such sum, in respect of bad and doubtful debts, due to the assessee in respect of that part of his business, profession or vocation, and in the case of an assessee carrying on a banking or money-lending business, such sum in respect of loans made in the ordinary course of such business as the Income-tax Officer may estimate to be irrecoverable but not exceeding the amount actually written off as irrecoverable in the books of the assessee:

Provided that if the amount ultimately recovered on any such debt or loan is greater than the difference between the whole debt or loan and the amount so allowed, the excess shall be deemed to be a profit of the year in which it is recovered, and if less, the deficiency shall be deemed to be a business expense of that year;

(xii) any expenditure (not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purpose of such business, profession or vocation;

(3) Where any building, machinery, plant or furniture in respect of which any allowance is due under clause (iv), clause (v), clause (vi) or clause (vii) of sub-section (2) is not wholly used for the purposes of the business, profession or vocation, the allowance shall be restricted to the fair proportional part of the amount which would be allowable if such building, machinery, plant or furniture was wholly so used.

(4) Nothing in clause (ix) or clause (xii) of sub-section (2) shall be deemed to authorise the allowance of any sum paid on account of any cess, rate or tax levied on the profits or gains of any business, profession or vocation or assessed at a proportion of or otherwise on the basis of any such profits or gains; and nothing in clause (xii) of sub-section (2) shall be deemed to authorise—

(a) any allowance in respect of a payment which is chargeable under the head 'Salaries' if it is payable without British India and tax has not been paid thereon nor deducted therefrom under section 18; or

(b) any allowance in respect of any payment by way of interest, salary, commission or remuneration made by a firm to any partner of the firm; or

(c) any allowance in respect of a payment to a provident or other fund established for the benefit of employees unless the employer has made effective arrangements to secure that tax shall be deducted at source from any payments made from the fund which are taxable under the head 'Salaries.'

(5) In sub-section (2), 'paid' means actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under this section; 'plant' includes

vehicles, books, scientific apparatus and surgical equipment purchased for the purposes of the business, profession or vocation; and 'written down value' means—

(a) in the case of assets acquired in the previous year, the actual cost to the assessee;

(b) in the case of assets acquired before the previous year but after the commencement of the Indian Income-tax (Amendment) Act, 1939, the actual cost to the assessee less all depreciation allowable to him under this section;

(c) in the case of assets acquired before the commencement of the Indian Income-tax (Amendment) Act, 1939, the actual cost to the assessee less for each financial year since acquisition the amount of depreciation applicable to the assets at the rates in force for each such year since the 1st day of April, 1922, and at the rates in force on the 1st day of April, 1922, for each such year prior to that date:

Provided that where the provisions of the proviso to sub-section (2) of section 26 are applicable, the actual cost to the assessee referred to in clauses (a), (b) and (c) shall be the actual cost to the person succeeded in the business, profession or vocation;

Provided further that there shall not be so deducted from the actual cost any depreciation allowance or part of any depreciation allowance which was due for a year which ended prior to the 1st day of April, 1939, but to which full effect was not given owing to the absence of profits or gains chargeable for that year, or owing to the profits or gains so chargeable being less than the allowance.

(6) A trade, professional or similar association performing specific services for its members for remuneration definitely related to those services shall be deemed for the purpose of this section to carry on business in respect of those services, and the profits and gains therefrom shall be liable to tax accordingly.

(7) Notwithstanding anything to the contrary contained in section 8, 9, 10, 12 or 18, the profits and gains of any business of insurance and the tax payable thereon shall be computed in accordance with the rules contained in the Schedule to this Act.

Business

This section deals mainly with the deductions allowed in computing profits and gains of business They are

(1) Rent of premises,

(2) Repairs of premises,

(3) Interest on capital borrowed,

(4) Insurance charges on plant, furniture, stock,

(5) Current repairs to building, machinery, plant,

(6) Depreciation,

(7) Sale or discarding (or obsolescence),

(8) Animals used for business,

(9) Land revenue, local rates, municipal taxes in respect of premises used for business,

(10) Bonuses, Commission to employees,

(11) Bad Debts,

(12) Business expenses in general

SS 3, provides for proportional allowances where part of buildings, machinery and plant are used for business purposes.

SS. 4, provides

(*a*) taxes or cesses on profits of any business, etc are not deductible,

(*b*) salaries paid without British India allowed or deductible if tax has been paid or deducted at source, under section 18.

(*c*) payments of interest, salary, commission, etc., made to partners are not allowed.

(*d*) payments to employee's provident funds unless the employer has made effective arrangements to get tax deducted from any payment made from the fund.

SS. 5, contains the meaning of "paid", "plant", "written down value".

SS. 6, provides that under certain circumstances, a trade association or professional association, etc., may be deemed to carry on business under section 10.

SS. 7, provides that the rules for the computation of profits of Insurance business are now enacted in the Act itself (previously these rules were framed under section 59).

Profit and Loss Account

Tax under this head shall be payable by an assessee on the income, profits, gains of any business, commerce, trade, manufacture profession, etc., carried on by him, subject to certain deductions.

The following may well serve as guiding principles to determine which items will not be allowed as deductions :—

(1) Appropriation of profits, *e.g.*, drawings, proprietor's salaries, interest on capital, income tax, etc.

(2) Items of capital nature, *e.g.*, improvements, formation expenses, etc.

(3) Expenses or charges which may be varied at will by the assessee, *e.g.*, provision for doubtful debts, depreciation beyond a statutory limit.

(4) Losses and expenses not inevitable in that particular business, *e.g.*, donations.

The method usually adopted in finding out the assessable profits of a business for income-tax purposes is as follows :—

(1) Take the net profit as shown by the profit and loss account.

(2) Add thereto any items debited in the profit and loss account, but not allowable.

(3) Deduct items credited in the profit and loss account but not allowable as credits.

(4) Deduct items credited in the profit and loss account which have already been taxed by deduction or which are assessable under some other head.

Illustration 41.

Trading and Profit and Loss Account

	Rs.		Rs.
To stock	1,200	By sales	3,900
To purchases	1,500	By stock	1,000
To gross profit	2,200		
	4,900		4,900
To rent	125	By G P	2,200
To rates	20	By commission	30
To electricity	15	By dividends	150
To gas	10	By sale of scrap materials	
To wages	10	of a building	100
To charities	5		
To repairs	25		
To commission	10		
To depreciation	55		
To Goodwill A/c	300		
To building extension	500		
To income-tax	75		
To net profit	1,300		
	Rs. 2,480		Rs. 2,480

Adjustment Account (for income-tax).

	Rs.		Rs.
To dividends ...	150	By net profit	1,300
To sale of building materials ..	100	By charities	5
To net profit as adjusted	1,930	By Goodwill A/c ...	300
		By building extension ..	500
		By income-tax	75
	Rs. 2,180		Rs. 2,180

The same net profit may be arrived at by recasting the profit and loss account afresh eliminating the non-allowables as indicated before.

NOTE (1) Charities and donations are not inevitable business expenses and therefore not allowable

(2) Goodwill and extension are capital items, therefore not allowed.

(3) Income tax It is an appropriation of profits, therefore not allowed.

(4) Dividends

(*a*) It is a foreign item not connected with trading profits.

(*b*) It is already taxed.

(*c*) It should be included under a separate head.

(5) Sale of a part of building is a capital gain, therefore not allowable as a credit.

It should, however, be noted that except in clear cases of trade expenses or trade receipts, all items are decided after a careful examination and explanation from the assessee.

Illustration 42.

Profit and Loss Account.

	Rs		
To Rent	200-0-0	By Gross Profit	10,000-0-0
,, Office Expenses	1,000-0-0	,, Loss	9,000-0-0
,, ,, Salaries	1,500-0-0		
,, Commission	600-0-0		
,, Repairs	700-0-0		
,, Interest on Capital (Senior Partner)	15,000-0-0		
	19,000-0-0		19,000-0-0

Solution

FIRMS ASSESSMENT

P. and L. Adjustment Account

	Rs		Rs
To Loss as per P. and L. Account	9,000-0-0	By Interest on Capital	15,000-0-0
To Balance being adjusted profits of the Firm	6,000-0-0		
	15,000-0-0		15,000-0-0

Assessable Firm profits	6,000
Less Interest on Capital	15,000
Minus	9,000

Senior partner

Interest on Capital	15,000-0-0	
Less ½ of minus 9,000	4,500-0-0	
	10,500-0-0	(A) Profits
Other Incomes (say)	6,000-0-0	
Total Income	16,500-0-0	

Junior Partner.

½ of minus 9,000 =	- 4,500-0-0	(B) Loss.
Other incomes (say)	1,000-0-0	
Net loss	3,500-0-0	

This loss can be carried forward.

NOTE. (A) and (B) above will make Rs. 6,000. as per adjustment account.

Illustration of Equitable adjustment in partnership accounts 43

Profit and Loss Account.

	Rs.	Rs.		Rs.
To Salary			By Gross profit	3,660
A	200			
B	60			
		260		
,, Office staff		730		
,, Rent		165		
,, Gas and electricity		155		
,, Bad debts reserve		190		
,, interest on capital:				
A	170			
B	220			
		390		
,, Legal charges		40		
,, Net profits		1,730		
		Rs. 3,660		Rs. 3,660

A and B in the above partnership share equally. Find out from the above the amount on which each has to pay tax.

Adjustment Account

	Rs.		Rs.
To balance being firm's assessable profits	2,610	By N. P.	1,730
		By salaries A and B	260
		By B D reserve	190
		By Interest on capital	390
		By Legal charges	40
	Rs. 2,610		Rs. 2,610

NOTE.—Partners' salaries are appropriations of profits and hence not allowable.

Legal charges are not allowed unless they are in connection with the realisation of bad debts.

Reserve is an appropriation of profits not allowable.

Interest on capital It is a capital item not allowable

The firm's assessable profits are Rs 2,610 If, now, this amount is equally divided and each one is to pay tax on Rs. 1,305, it will be inequitable inasmuch as the partners do not get equal salaries or interest on capital The equitable division and the only correct division will be as follows :—

Firm's assessable profits	Rs	Rs 2,610
Less salary A and B ...	260	
Less Interest on capital	390	
		Rs 650
		Rs 1,960

Rs 1,960 equally divided .		Rs
A .	980	
B	980	
Hence, A will be taxed on		980
		200 salary
		170 interest
		1,350
and B will be taxed on		980
		60 salary
		220 interest
		1,260

A on Rs. 1,350
B on Rs. 1,260

2,610 (Firm's assessable profits).

Meaning of depreciation and the important rates

Depreciation is shrinkage in the value of assets by use or effluxion of time. This shrinkage is strictly a capital item, therefore in the English system of income-tax no allowance is given as depreciation, but allowance is shown in another form, *viz.*, wear and tear. Instead of meeting this important requirement of business indirectly, the Indian Act has directly provided for it by allowing a fixed rate as depreciation.

It is only the particular classes of buildings, machineries, plant or furniture mentioned in rule 8 in respect of which the depreciation allowance can be claimed for the purpose of business only if such business is carried on by the owners of such properties.

The depreciation rates of some very important and common items are given below For detailed information, see Rule 8 (re: an allowance under section 10(2)(*vi*) of the Act in respect of depreciation of buildings, machinery, plant or furniture).

	Rate Percentage on the written down value.
1 Buildings—	
(1) First class substantial buildings of selected materials	2.5
(2) Buildings of less substantial construction	5
(3) Purely temporary erections such as wooden structure	10
2. Machinery and Plant (General rate)	7
3. Furniture and Fittings (General Rate)	6
4. Rates sanctioned for special industries—Flour Mills, Rice Mills, Bone Mills, Sugar Works, Distilleries, Ice Factories, Aerating Gas Factories, Match, Tea, Leather-goods, Starch Factories	9

	Rate. Percentage on the written down value
5. Paper Mills, Ship Building and Engineering Works, Iron and Brass Foundries, Aluminium Factories, Electrical Engineering Works, Motor Car Repairing Works, Galvanizing Works, Patent Stone Works, Oil Extraction Factories, Chemical Works, Soap and Candle Works, Lime Works, Saw Mills, Dyeing and Bleaching Works, Cement works using rotary kilns, Brick Manufacture, Glass Manufacture	10
6. Sewing machines for canvas or leather	15
7. Motor cars	20
8. Indigenous Sugar-cane crushers (Kolhus or Belans)	18
9. Motor taxis, motor lorries and motor buses	25
10. Electrical Batteries	20
11. Electrical machinery, including electrical generators, motors (other than tramway motors), switch gear and instruments, transformers and other stationary plant and wiring and fittings of electric light and fan installations	10
12. Textile Machinery	9 to 10
13. Typewriter, Surgical Instruments, Wireless apparatus, Building Contractors Machinery	15
14. Cinema recording, reproducing equipment, Developing Machine, Printing, Editing Machine, Synchronisers, Studio lights, etc.	20

THE NEW GORAKHPUR SUGAR & GUR REFINING CO., LTD.

Trading and Profit and Loss Account.

	Rs.		Rs.	Rs.
To stock of sugar and molasses	2,00,000	By sugar sales	4,25,000	
To Manufacturing and other charges:—		By molasses sales	7,650	
Sugar-cane purchase	1,25,000		- -	4,32,650

		Rs.		Rs.
Lime		750	By Stock of sugar and molasses	2,00,000
Sulphur		450		
Filter press cloth		300		
Stores		500		
Coal		3,500		
Firewood		1,500		
Gunny bags		1,200		
Laboratory stores		450		
Manufacturing acids		150		
Lubricants, etc.		550		
Salaries and wages		25,000		
*Cane growing		72		
Medical charges		1,528		
*Law charges		300		
Printing and stationery		350		
Travelling expenses		1,250		
Charges general		17,750		
Repairs and renewals		3,500		
*Rents		3,600		
Insurance		400		
Interest		250		
Provident Fund contributions		1,400		
Director's fee		1,600		
Sugar Excise Duty		45,000		
Selling Commission		1,500		
Managing Agents' allowance		600		
Managing Agents' commission		6,000		
*Staff commission and bonus fund		1,200		
*Depreciation				
Building	3,000			
Machinery	6,000			
Electric installation	4,000			
Railway siding	5,000			
Furniture	1,500			
Motor cars	2,500			
		22,000		
Income-tax and super-tax		40,000		
Net Profit		1,25,000		
		6,32,650		6,32,650

P. & L. Adjustment Account.

	Rs. a. p.		Rs. a. p.
To market value of sugarcane grown by the Company and crushed for manufacture	370 0 0	By N.P.	1,25,000 0 0
		By Depreciation	22,000 0 0
		By Cane-growing	72 0 0
		By Bonus fund	500 0 0
To Adjusted Profit	1,87,202 0 0	By Income-tax and S.T.	40,000 0 0
	1,87,572 0 0		1,87,572 0 0

Adjusted Profit as above		1,87,572 0 0
Less Depreciation	Rs. 20,000	
Less unabsorbed balance	Rs. 27,572	
		47,572 0 0
	Total	1,40,000 0 0

*NOTE. (1) Cane growing cost amounts to Rs. 72 for 1,200 maunds of sugar cane. In accordance with rule 23(1), the Company is entitled to deduct the market value of the sugar cane produced and used for manufacture, the market value is taken to be Rs. 370.

(2) Staff commission and bonus includes a contribution of Rs. 500 to bonus fund account.

(3) According to the schedule Rs. 20,000 is allowed for Depreciation. It has been assumed that depreciation allowance of Rs. 27,572 remained unabsorbed in the previous years.

(4) I. T. O. is satisfied that law charges are a Revenue Expense.

Depreciation

(1) The assessee has to keep an account of the original cost (original cost to the person who is being actually assessed and not to the previous owner of the business) of the buildings, plant, etc., and also actual allow-

ances granted each year for depreciation on the diminishing balance method.

(2) Asset depreciated must belong to the assessee.

(3) Asset must be used for business, profession or vocation. Mark the word "such" which means that buildings, etc for which depreciation is claimed must be used for that particular business, profession or vocation whose profits are being computed

(4) Asset must come under the list in rule 8.

(5) Original cost includes cost of freight, all incidental expenses connected with the acquisition of the assets, pay of engineering staff who erect the machinery and all such expenditure up to the point of actually starting work.

(6) Under the old Act, depreciation was allowed on the original cost of the asset at scheduled rates until the assets were brought to nil value

(7) Under the new Act, depreciation will be allowed on the written down value of assets at the rates prescribed in a schedule

(8) **Written down value** (or diminishing balance valuation) means

(*a*) the actual cost to the assessee, in the case of assets acquired in the previous year,

(*b*) the actual cost to the assessee less depreciation allowable, in the case of assets acquired before the previous year but after the Income-Tax Amending Act, 1939, came into operation.

(*c*) the actual cost to the assessee less depreciation at the old rates for the years since the asset acquired, in the case of assets acquired before the Amendment Act of 1939 came into operation.

Taken along with the second proviso now added to the definition, contained in sub-section (5) of section 10 of the Act, of the words "written down value" this alteration substitutes for the proposals regarding depreciation contained in the Bill provisions which remove the restriction of depreciation to the amount written off in the books of the assessee, remove the restriction to six years of the carry forward of depreciation, and secure that depreciation which is unabsorbed at the time when the law is changed shall not be deducted from the original cost of plant, machinery, etc, in arriving at the written down value The effect of this provision is to spread the writing-off of the unabsorbed depreciation over a long period The proposals contained in the Bill limited the amount of depreciation to the amount written off in the books of the assessee and treated depreciation arising after the change of the law as a loss like other losses so that it could be carried forward only for six years Depreciation unabsorbed at the time of the change of the law was to be carried forward without time limit until it was absorbed but was to be deducted from that is to say, allowed against profits before any further allowance for depreciation was to be made for any particular year subsequent to the change of the law Select Committee Report

(9) Actual cost to a successor is the cost to the person succeeded

(10) Unabsorbed depreciation shall not be deducted from the cost of the asset

In other words, if the total due depreciation is deducted from the asset, then for the purpose of the written down value, the unabsorbed depreciation has got to be added To make it simpler, the W D value is the actual cost less the absorbed depreciation

Illustration 45.

Suppose an asset was bought for Rs 8,000 Depreciation allowed so far was Rs 300 If Rs 500 be the depreciation due in the past years which could not be allowed owing to inadequacy of profits, this Rs. 500 should be added to Rs 7,200 (Rs. 8,000 - 800 = Rs. 7,200) and

therefore the written down value would be Rs. 7,700 at the start of the new Act.

We have also added a proviso, already referred to in our remarks above on Clause 10(b)(iii), to ensure that depreciation allowance due for a year prior to the change of the law but unabsorbed shall not be deducted from original cost in arriving at the written down value. (Select Committee Report.)

(11) Determination of written down value (W/D value):

(1) Until the Act of 1939, depreciation was allowed on prime cost but now on diminishing cost

(2) The first assessment on the new system will be assessment year 1940-41.

Illustration 46.

(3) If an ordinary case under section 10(5)(c) is taken, suppose the asset was acquired in December, 1932, for Rs. 50,000 and the rate of depreciation is 5 %, then the W/D value would be

Rs 50,000 Cost to the assessee

Less 5 % depreciation Rs 15,000 (for 1934-35 to 1939-40).

Rs 35,000 being W/D value for 1940-41.

assuming, however, that there is no unabsorbed depreciation outstanding.

(4) Depreciation claims up to and including that of 1938-39 shall be met from the profits for the assessment year 1939-40. If there now remains any unabsorbed depreciation it shall be capitalised.

(5) Depreciation claims of 1939-40 shall also be met from the profits for the assessment year 1939-40. If there now remains any unabsorbed depreciation, it shall be carried forward.

Illustration 47

Assessment year 1939-40.

Supposing A's business profits are ...	Rs. 50,000
and interest on securities	Rs. 20,000
Total Income	Rs. 70,000
Supposing his depreciation claims are	
(*a*) brought forward from assessment year, 1938-39	Rs. 90,000
(*b*) due for assessment year 1939-40	Rs. 10,000
	Rs. 1,00,000

Therefore unabsorbed depreciation brought forward from 1938-39 after setting off income for 1939-40 assessment is

Rs. 20,000 (70,000 - 90,000)

and for 1939-40 Rs. 10,000

Therefore at the end of 1939-40 assessment, the depreciation which remains still unabsorbed, *i.e.*, Rs. 20,000 shall be capitalised for the purpose of the next assessment year

But the unabsorbed depreciation which became due in the first year under the Amendment Act, *i.e.*, (1939-40), Rs. 10,000 will be carried forward as depreciation claims against future profits.

Illustration 48.

If the original cost of the asset acquired in February, 1934 (assessment year 1934-35) is assumed to be Rs. 5,00,000 then the W/D value will be as follows :—

1940-41 assessment.

Rs. 5,00,000

add Rs. 20,000 capitalised as per previous illustration.

Rs. 5,20,000

Less depreciation for last 5 years at 10 Rs 2,50,000

Rs 2,70,000

Or to put the same thing in another way :—

		Rs. 5,00,000
Less Rs	2,50,000	
Less Rs	20,000	
		Rs. 2,30,000
		Rs. 2,70,000

Therefore this year, 10 on Rs. 2,70,000 = Rs 27,000

add unabsorbed depreciation from 1939-40 = Rs. 10,000

Hence, allowance for 1940-41 = Rs 37,000

(12) Mere forwarding particulars of depreciation will not entitle an assessee to depreciation allowance; he shall file the particulars in the prescribed form as required by section 10(2)(*vi*) proviso (a) [PR. AL. M. Muthukaruppan Chettiar *vs.* C.I.T., Madras, 1939, I.T.R. 76].

(13) The depreciation carry forward and the loss carry-forward must not be mixed up; as the former can be

continued for indefinite period of time, whereas, **the latter can be continued for only 6 years.**

That portion of the claimed depreciation which the profits of the business can absorb does not raise any difficulty.

That portion of the claimed depreciation which the profits of the business cannot absorb, owing to inadequacy of profits, raises great difficulties, *viz.*,

(*a*) Will this unabsorbed portion be carried forward next year and every year? or

(*b*) Will this unabsorbed portion be debited to the P and L A c notwithstanding inadequacy of profits and thus show a loss, which loss will, under section 24, be set off and this operation to continue 6 years only?

This (*b*), however, is a direct negation of the provision that unexhausted depreciation allowance is to be carried forward indefinitely.

(14) The clause in the proviso (*b*) to section 10(2)(*vi*), *viz.*, "profits or gains chargeable for that year" is not very clear. The doubt in our mind can reasonably be as to whether these expressions in this section refer to

(*a*) profits of business as *general head*, or

(*b*) profits of business or the concern as a *unit source*.

From the reading of the proviso, it seems quite reasonable to think that it refers to business as a head (not each concern as a unit of business). But as this interpretation will be in conflict with section 24(2) where *same* business, profession, vocation has been mentioned, it is necessary to accept the interpretation that each business unit is meant. From the following *illustration 49*:—

X Business (Druggist's Stores)

P. & L. Account.

	Rs.		Rs.
Office Expenses ..	2,500	By Gross Profits ..	5,000
Trade Expenses .	2,000	,, Loss .	1,500
Depreciation	2,000		
	6,500		6,500

(Without debiting Depreciation)

P & L. Account.

	Rs.		Rs.
Office Expenses	2,500	Gross Profits ..	5,000
Trade Expenses	2,000		
Profits	500		
	5,000		5,000

NOTE – Depreciation claim is Rs. 2,000

Y Business (Sports goods)

P & L Account

	Rs.		Rs.
Office Expenses	5,000	Gross Profit ...	10,000
Trade Expenses	3,000		
Depreciation	1,000		
Net Profit	1,000		
	10,000		10,000

Illustration 50.

The conclusions are :—

(1) if general head "business" is taken, then unabsorbed loss to be carried forward is Rs. 500 as under :—

X 500 profits
Y 2,000 ,,

and X 2,000 depreciation

Y 1,000 depreciation.

But the difficulty is how to find out the depreciation carry forward and the loss carry forward of each business?

(2) if unit concern is taken, then the

X profit Rs 500, Depreciation claim
Rs. 2,000 – 1,500

Y profit Rs. 2,000, Depreciation claim
Rs 1,000 ; 1,000

The ultimate figure is the same loss of Rs 500 in both; but under (1), the units lose their identity but under (2), loss carry forward and depreciation carry forward of each unit are kept distinct.

Then later on, when we come to section 24(1), for the purpose of interpreting "loss of profits or gains in any year under any of the heads", the result of X and Y's trading together has got to be taken, *i.e.*, *minus* 500. This point can be more clearly brought out in the process of rebutting the contrary contention. The contrary contention may be this --

> the unit concerns being taken separately, the unabsorbed depreciation of one unit shall be set off against business profits of the *same* unit concern, otherwise it will be carried forward till that unit has profits.

But this contention means that the expressions "loss of profits and gains . . ." under section 24(1) are given too narrow an interpretation without any justification or authority.

Illustration 51.

Continuing the illustration 50, if :—

X business.

P. and L. A/c.

	Rs.		
Office Expenses	... 2,500	Gross Profit	.. 3,200
Trade Expenses	... 2,000	Loss	1,300
	4,500		4,500

then the entire depreciation claim Rs 2,000 is carried forward and Rs. 1,300 business loss is to be set off against profits of Rs 1,000 (Y business profit Rs 2,000, less its depreciation claim Rs 1,000) and under the general head "business", loss of Rs. 300 will be shown. If the person has other incomes from salary and other heads, this *minus* quantity (Rs 300) can be set off.

The larger objection to this method of finding out business loss is that business loss of Rs 1,300 is found out without debiting the most legitimate charge in a business namely, depreciation. Our defence lies in the fact that the Act requires that the depreciation claim must be kept distinct and separate from business loss and it should be treated in the manner laid down in the proviso, though from the accountancy point of view it is indefensible. But this question pertaining to income tax has to be decided by the Income Tax Act.

(15) Letting machinery on hire:—Section 10 will apply as this comes under the definition of business. The machinery must be the property of the assessee and used for business. Refer to section 12(3).

(16) Plant has now been defined so as to include vehicles, books, scientific apparatus and surgical instruments.

(17) If a machinery is leased out on condition that the lessees pay a certain rent and carry out repairs to the machinery, the lessor is entitled to allowances under Section 10(2)(vi). [Sadhucharan Roy Chaudhury 1935, I.T.R. 114] See section 12(3).

(18) Succession by bequest In C.I.T., Burma, *vs.* Solomon & Sons (1933, I.T.R. 325), the assessees acquired property by bequest. It was decided that the original cost to the assessee is the real value of the property at the time of acquirement.

(19) Machinery, etc. for which depreciation is claimed must be used during the year of account. Any allowance claimed must be on account of the same period for which tax is imposed, *i.e.* previous year.

(20) Both machinery and plant are meant to assist production directly or indirectly.

Machinery means "some mechanical contrivances which by themselves or in combination with one or more other mechanical contrivances by the combined movement and interdependent operation of their respective parts generate power or evoke, modify, apply or direct natural forces with the object in each case of effecting so definite and specific a result." [Corporation of Calcutta *vs.* Cossipur Municipality, 49 Cal. 190 (P.C.)]

"Plant" includes whatever apparatus is used by a business-man for carrying on his business, not his stock-in-trade which he buys or makes for sale but all goods and chattels, fixed or movable, live or dead which he keeps for permanent employment in his business." (Yarmouth *v.* France, 57 L.J.Q.B. 7)

(21) Section 10(2)(*iv*) refers to insurance allowance in respect of building machinery, plant, furniture, stocks or stores.

Section 10(2)(*v*) refers to current repairs allowance in respect of building, machinery, plant or furniture.

Section 10(2)(*vi*) refers to depreciation allowance in respect of building, machinery, plant or furniture.

Section 10(2) (*vii*) refers to obsolescence allowance in respect of machinery or plant.

(22) Businesses of long standing will suddenly find their depreciation allowances considerably reduced. In some cases, it will be a serious blow.

(23) Payment of bonus or commission if actually made in course of business should not be left to the scrutiny of any person other than the proprietor; he knows why he is giving the bonus. But the Act empowers the I.T.O.

(24) In the Case of Amrita Bazar Patrika, Calcutta, 1937, I.T.R. 648, where the Editor and the Printer were charged with contempt of Court, the expenses incurred by the Patrika in defence of these persons could not be regarded to have been incurred for purposes of earning the profits.

(25) A lawyer incurring expenditure in the maintenance of his Motor Car, will not be allowed this deduction (Sir Hari Singh Gour *vs.* C.I.T., U.P., C.P., 3 I.T.C. 333).

An engineer's Motor Car expenses may not be ordinarily allowed but a contractor's expenses should be always deducted.

A doctor should be always given this allowance and also an auditor, frequent visits being essential.

(26) In Bengal Nagpur Railway Company *vs.* Secretary of State, 1922, 49 Cal. 815, the railway company managed the line owned by the Secretary of State and was assessed on (*a*) interest on Capital supplied by the Secretary of State, (*b*) guaranteed interest payable by the Secretary of State on the share capital of the company found by the railway company. It was decided that the company was liable to be assessed on the company's surplus profits and it was also decided that in such cases, the liability

to pay tax depends on special agreements between the parties.

(27) In C.I.T. Bihar *vs.* Sir Kameshwar Singh 1933, I T.R. 94 (P.C), the assessee, on discovering that in acquiring a colliery, there were arrears of fixed or dead rents (royalty) due to superior landlord, claimed deduction in computing profits The Privy Council decided that the sum overpaid by the assessee for the colliery was to get possession of the colliery, not a sum expended by him in the carrying out of the colliery Hence the claim was disallowed.

(28) In Dr Sir H S Gour *vs* C I T C P 1929, 3, I T C 350, the assessee did not include in his return some miscellaneous receipts, some dividends, some fees from university examinations and some of his publications of books When I T O found these omissions he added a sum of Rs 20,000 as for general omissions It was held that as I T O was justified in treating the return as unreliable, his estimate was neither unreasonable nor illegal

(29) In the Indian Turpentine and Rosin Co Ltd *vs* C I T U P 1928, 3 I T C 219, the company was originally owned by the Government of U P When it became a joint stock company with a capital of 12 lakhs, shares of 6 lakhs were allotted to the local Government and the latter was to supply through its forest department crude resin at cost plus a royalty of Re 1 per maund and also on condition that if the profits of the company in any year exceeded 15 per cent, a further payment of 40 of the excess profits was to be made in the following year as additional royalty The company claimed to deduct as business expense the share of its profits in the preceding year paid in the accounting year as additional royalty to Government. It was held that the additional royalty was the price paid for resin and was expenditure incurred for earning profits and hence deductible under sec 10(2).

DEPRECIATION IN CASES OF SUCCESSION

Where a person carrying on business, etc., has been succeeded by another person, such person is entitled to carry forward under Section 10(2)(*vi*) the depreciation in respect of buildings, machinery, plant, etc., in case where full effect could not be given by the person in the years prior to the succession.

In C.I.T., Madras, vs. Massey Co. Ltd., 1929, 3 I.T.C. 302.

(1) Massey Co. was a Company in British India.

(2) Assessment was for 1927-28.

(3) Succession took place from 1st January, 1924.

(4) Predecessor Company—Madras Engineering Works, Successor Company Massey & Co. Ltd.

(5) The High Court had two questions before it :—

(*a*) whether the Massey & Co. are entitled to carry forward depreciation to which full effect could not be given in the years previous to succession.

(*b*) whether Massey & Co. can be allowed to calculate depreciation on the original cost to the predecessor or on the cost to the successor.

(6) The Income-tax Commissioner contended that it should be on cost to the transferee Co. The High Court decided that it should be on cost to the transferor Co.

C.I.T. vs. Buckingham & Carnatic Co, Ltd., 1935, I.T.R. 384

(1) Company in British India.

(2) Successor Co. Buckingham, etc.

(3) Predecessor Co.—Five Limited Companies.

(4) Succession took place on 30th November, 1920.

(5) In 1921-22 assessment (subsequent to succession),

the successor claimed depreciation on the original cost to the predecessor as the profits assessed in the hands of the successor were profits to the predecessors (*viz.*, the five limited companies). This claim was not accepted by the Tax authorities and the Company was assessed on the actual cost to the Company.

Just after the decision of the Massey Co., Buckingham Carnatic Company renewed its claim in the assessment for 1931-32 on the strength of the decision in the Massey Co.'s case.

The High Court decided in favour of the Company.

Then the case was sent up to the Privy Council, which observes that in this case the point to be noted is that the year of assessment under discussion is not the first year after succession but a subsequent year. This distinction has been drawn in a later case of Mazagaon Dock, Ltd., by the learned Chief Justice of Bombay High Court, although such a distinction is not supported by any section of the Income Tax Act.

With regard to the question whether the original cost referred to the transferor or to the valuation at which the transferee took it, the cost to the (transferee) purchasing Company was decided to be the basis on which depreciation was to be calculated.

C.I.T., Bombay, *v.* Mazagaon Dock, Ltd., 1938, I.T.R. 124.

(1) It is an assessment for 1935-36.

(2) On 1st April, 1935 the Mazagaon Dock, Ltd., acquired the assets of the Firm of Mazagaon Dock.

(3) The Limited Company, *i.e.*, the successor is the assessee Company.

The Bombay High Court decided that depreciation allowance should be calculated on the cost to the transferor

company and not to the purchasing Company, *viz.*, the Mazagaon Dock, Ltd.

The Chief Justice and Justice Rangnekar pointed out the distinguishing feature of this case from the Buckingham and Carnatic Company and held that cost to the predecessor would be the basis. Justice Rangnekar observes:

"This is not a case of an ordinary assessment of income actually made by the successor ... upon the whole, therefore, I have reached the conclusion that in this case where we are only concerned with a hypothetical assessment in the very first year of a successor taking over his business from his predecessor, apart from the fact that the words "original cost" would be inappropriate, it would be difficult to hold that depreciation should be allowed on the original cost to the successor and not on the original cost to the predecessor."

Justice Blackwell dissented and said:

"It may be that it would be just to amend the Act to meet a case for the [illegible] and upon the plea that justice requires it, I do not feel myself at liberty to place upon section 10(2)(vi) a strained artificial meaning in the first year after a succession, while giving to it, as I am bound to do by the ordinary canons of construction and upon authority, its plain and natural meaning in the years following."

The Chief Justice observes:

"In my opinion, therefore, it is open to this court to consider on its merits the question whether in the case of a fictional assessment under Section 26(2), "assessee" in section 10(2)(vi) has the same meaning as it bears for the purpose of subsequent assessments and means the person being assessed or whether it means the person on whose profits the assessment is based and who was the owner of the premises on which depreciation is claimed during the year in which the profits were earned. For the reasons given above, I am of opinion that the latter view is right."

Therefore where assessment is made on a successor under Section 26(2) the word "assessee" in Section 10(2)(*vi*) must be construed as predecessor.

Interest on capital borrowed for business, profession or vocation.

This interest was admissible where the payment was not in any way dependent on the earning of profits. By the Amendment of 1939 :—

(1) this restriction has been omitted

(2) no allowance is admissible where the interest is payable outside British India unless tax has been deducted

(3) interest paid to partners is not admissible even if it can be proved that the partner gave a loan and not capital

Obsolescence, in the old Act, created some difficulties as to what is obsolete and when it is so. In the Amendment Act of 1939, the expression "obsolete" has been omitted and it has been provided that the amount shall be allowed whenever the plant or machinery has been sold or discarded, *i.e.* when it is actually written off in the assessee's books. The claim can be allowed either in the year of discarding or of sale.

The allowance in the P. & L. A/c. will be the difference of the written down value and the sale proceeds.

Conversely, any excess due to larger sale proceeds than the written down value would be income and taxable.

Bad Debt:

(*a*) allowed in mercantile system of account keeping only.

(*b*) allowed as estimated by I. T. O.

(*c*) must not exceed the amount written off in the books.

(*d*) such bad debts as are incurred in the year of account.

(*e*) the assessee is not the sole judge nor has he any option to declare debts bad. It is a question of fact and therefore in case of dispute, it is to be decided by the proper tribunal.

(*f*) A statute-barred debt is not necessarily bad.

The above three (*d*, *e*, *f*.) points were decided by the Privy Council in the case of C.I.T. *vs.* Sir S. M. Chitnavis (1932, 59 I.A. 219).

(*g*) the question as to at what point of time, a debt becomes bad is purely a question of fact and therefore no reference to the High Court lies (C. I. T., C. P. & U. P. *vs.* Seth Birdichand, 1938, I. T.R. 367). But the question whether there is any evidence for such a finding by the Tax authorities falls within the question of law and in this respect reference lies (Hukumchand Jagdharmall *vs.* C. I. T., Punjab, 1935, I. T. R., 211).

(*h*) Assessee obtained a personal decree against his debtor in 1928. Against this decree the debtor appealed and it was dismissed in 1931. The assessee could not realise anything. For 1932-33, the assessees claimed it as bad debt.

Income Tax Officer held it was bad in *1929*, hence not allowable now. Assistant Commissioner held it was not bad even in *1932-33*. The Commissioner agreed with I. T.O.

High Court agreed with A. C. and decided that the Income-tax authorities should decide whether it became bad in 1932-33 (Hukumchand Jagadhar Mull *vs.* C. I.T., Punjab, 1935, I.T.R., 211).

(*i*) It is for the assessee to prove by evidence that a debt became irrecoverable during the year in

which incomes arose (C I.T. *vs.* Vallabhdas Murlidhar, Bombay, 4, I T.C. 318).

(*j*) A bad debt or irrecoverable loan cannot be allowed as a deduction unless:-

(*a*) the assessee has written it off his accounts.

(*b*) it has actually become bad or irrecoverable, and

(*c*) it actually became so *in the "previous year"*

(*k*) The word "irrecoverable" in the term "irrecoverable loan" should be given a wider sense than its technical legal meaning

Mr S P Chamber-

"I think on the question of estimating Bad and Doubtful Debts the position is not so severe as the Honourable Member imagines. There is the right of appeal and if either the income-tax officer or the assistant commissioner [illegible] applied his mind to the facts then there would be [illegible] reference to the High

Business deductions Irrecoverable Loans

(i) Where an assessment is made of profits or income from a banking or money-lending business, loans which cannot be recovered should be deducted from the assessed profits of such business at the time when such loans can be definitely proved to be irrecoverable. For example, if a banker has lent out 5 lakhs of rupees and received Rs 50,000 as interest but has during the same year lost an irrecoverable loan of Rs 25,000, he should be assessed on Rs 25,000. Similarly, if the same banker receiving Rs 50,000 as interest on his loans suffers a loss of an irrecoverable loan amounting to one lakh during the same year, the income to be assessed to income-tax from the money lending business in that year will be nil. These examples will apply whether the assessee had previously been assessed to income-tax or not.

(ii) This instruction will also apply to the assessment of other traders, where loans have been made in connection with the business and in which the loans are of the nature of the business and the loss is a true trading loss.

(*iii*) The irrecoverable loans in the sense referred to in this paragraph are sometimes confused with the "bad debts" described in paragraph 50, but they are of a totally different nature. Money lent out on interest is the stock-in-trade of a money-lender or banker and the loss of such stock-in-trade can clearly be regarded as a trading loss like the loss of the stock-in-trade of any other trader where the loss is not covered by insurance. In settling claims of this nature the question has always to be considered whether money-lending is, or is not, a part of the business of the trader in question. The investment of savings or occasional loans made to acquaintances cannot be considered to be loans made in the course of trading." (I.T.M.)

Mr. S. P. Chambers said in connection with irrecoverable loan:

"If he has several businesses he may keep part of his books in cash and part on a mercantile basis as I understand is the common practice in South India. . . . In other business loans and capital sums are not allowable deductions. In the case of a bank or money-lending business, these loans or other sums represent part of what might be called trading stock of the business so that in the case the money-lender even if he keeps his books on the cash basis, allowance must be made for so much of the loans as proved to be irrecoverable."

Depreciation of Securities held by Bank:—

In Tata Industrial Bank (1 I.T.C. 152), Macleod C. J. observed:—

"From the gross income only certain debits for depreciation are to be allowed and this debit asked for by the Bank not being mentioned therein cannot be allowed . . . an assessee would not be allowed to write down his assets in a year when market values had declined without writing them up when values had increased."

In Punjab National Bank, Ltd. *vs.* Crown 1926, 2 I.T.C. 184:

The bank claimed depreciation on securities because such investments were of the same character as loan advanced to customers. It was decided that the securities in question being a part of the fixed capital and not a part of stock-in-trade of the Bank, the deduction was not allowable.

Depreciation when machinery is idle:—In C.I.T., Bombay, *vs.* V. B. Sathe, (1937, I.T.R. 624), the assessee owned a ginning factory and he was a member with the owners of other ginning factories of a pool. During the year of assessment, the assessee's factory did not work and the I.T.O. declined to allow depreciation. According to pooling agreement the assessee was to keep his gins, etc., in working condition and according to Beaumont, C. J.: the depreciation was allowed. The Chief Justice observed:

> "The business from which the profits were derived was that of ginning factories and the contribution of the assessee to that business was the obligation to keep his machinery ready for actual use at any moment. It seems to me that the ultimate test is whether without the particular user of the machinery relied upon, the profits sought to be taxed could have been made . . I base my decision entirely on the existence of such a covenant in the case."

In Bhikaji Venkatesh *vs.* C. I. T., C. P. & U. P. (1937, I. T.R. 626), the assessee owned a ginning factory and was a member of a pooling association of ginning factories. Under the agreement, the factories worked in rotation and in this year, the assessee's factory did not work. It was decided that the words "used for the purpose of business" meant "actually used" and therefore depreciation for the year of assessment was not allowed.

Items allowed in the P. & L. A c:

(1) Where depreciation allowance is not asked for, the cost of replacement should be allowed in the year in which a furniture is replaced.

(2) Debenture interest.

(3) Deduction in the profit and loss account should be allowed in respect of any sums paid on account of land revenue, local rates, cess or municipal taxes in respect of such part of the premises as is used in business.

(4) Obsolescence (sold or discarded) allowance.

(5) **Depreciation according to scheduled rates.**

(6) **Irrecoverable loans.**

(7) **Pension to ex-employees.**

(8) **Bonus or Commission paid to employee allowable under the following conditions:**

(*a*) Where such sum would not have been payable to him as profits or dividend if it had not been paid as bonus or commission.

(*b*) Reasonable amount considering pay and conditions of service, profits of the business and general practice in similar business.

(9) Interest on borrowed capital.

(10) Provident Fund allowances.

(11) Sums paid on account of land revenue, local rates, municipal taxes in respect of such part of premises as is used for profession, business, vocation etc.

(12) Under section 10(2) (*xv*), "laid out or expended wholly" suggests that many items of expenditure which have hitherto been disallowed as being of capital nature may be brought under it and deduction can be claimed against profits of the business.

Items **Not Allowed** in the P & L A c:—

(1) Premium received by a company on shares.

(2) Cost of issuing shares.

(3) Reserve for bad debts or for any fund.

(4) Charities and presents

(5) Cost of additions, alterations, extensions, improvements, etc

(6) Income-tax and super tax.

(7) Drawings or salaries to proprietors.

(8) Interest on partners' capitals or loans.

(9) Private or personal expenses.

(10) Road, public works cess and similar cesses on income from royalties. (Raja Jyoti Prasad Singh's case, 1921, 1, I.T.C. 103, Bihar.)

(11) Any loss recoverable under an insurance.

(12) Legal charges except in realisation of bad debts, etc.

(13) Commission to under-writers.

(14) Ex-partners' pensions.

Obsolescence Allowance.

This allowance under section 10(2)(vii) is in respect of plant and machinery only. Previously this used to be called obsolescence allowance. By the new amendment the word, obsolescence, has been omitted altogether. It is now a case where a machinery or plant is sold or discarded and written off in the accounts.

If a plant or machinery is discarded or sold and the firm has written off its residual value in the profit and loss account, then for income-tax purposes, the amount which will be allowed as debit in the profit and loss account will be

Written down value,

Less scrap value realised.

Illustration 52.

A machinery cost Rs 600. After full 3 years of use, it became obsolete and was sold off for Rs. 135 Depreciation was allowed at 10% each year What amount will be deductible allowance?

Original cost to the assessee			Rs 600
Less depreciation 10%	(1st year)	...	Rs 60
			Rs. 540
Less depreciation 10%	(2nd year)	..	Rs. 54
			Rs. 486

Less depreciation 10%	(3rd year) ...	Rs. 48
		Rs. 438
Less scrap value		Rs. 135
Allowance in the P and L account		Rs. 303

The allowance for obsolescence is calculated upon the original cost to the owner.

Method of converting the net profits of sterling companies into rupee for the purposes of income tax.

Where the business of a sterling company is transacted entirely in India, there is no need for the Income-tax Officer to look at the sterling accounts as he can get a record and ask for a return of the transactions in rupees. He should act in the same way in cases where the profits of the Indian branch of a company operating in other countries can be separately ascertained. In the case of a company operating through local branches in different countries where the profits of the Indian branches cannot be ascertained separately but have to be deducted from the total sterling profits of the company from all its operations, the net profits of the company for the purposes of assessment to Indian income-tax should be converted into rupees at the rate of exchange ruling on the last day of the year to which the account relates unless the Income-tax Officer is able, by an examination of the accounts, to ascertain the average rate of remittances throughout the year and to deduce from that the rupee profits of the Indian branches. (I T M)

In Vallambrosa Rubber Co. *vs.* Farmer (1910, 5 T.C. 529) an English Case, the assessee, a Rubber Estate, claimed an allowance for the entire amount of expenditure in superintending, weeding, etc , on the whole of the plantation. The tax authorities contended that expenditure on only that portion which was producing rubber in the year and not on the rest which was in the process of cultivation was deductible Lord Dunedin accepted the company's contention and observed :

"Supposing a man conducted milk business, it really comes to the limits of absurdity to suppose that he would not be allowed to charge for the keep of one of his cows because at a particular

time of the year, towards the end of the year of assessment, that cow was not in milk and therefore the profit which he was going to get from the cow would be outside the year of assessment."

Expenses on a rubber estate on acquiring and clearing and draining land before cultivation was started is capital expenditure but the expenditure on cultivation, production and marketing is Revenue expenditure.

Payment out of Profits:—

In the Pondicherry Railway Co., Ltd., *vs* C. I. T., Madras, 1931, 5, I.T.C. 363, it was stated by Lord Macmillan that "a payment out of profits and conditional on profits being earned cannot accurately be described as an expenditure incurred to earn profits."

Payment for earning Profits:—

In the Indian Radio and Cable Communications Co., Ltd. *vs* Commissioner of Income-tax, Bombay, 1937, I.T.R., 270, it has been decided by the Judicial Committee that a payment which is made out of profits and conditional on profits being earned may yet be expenditure incurred for earning such profits and so allowable. The real issue is whether the expense was for earning profits. If according to an agreement a manager is paid 5 per cent on the net profits of the year, this 5 per cent should be allowed as a business expenditure.

In the Tata Hydro Electric Agency *vs* C. I. T., Bombay, 1937, I.T.R. 202, the Judicial Committee pointed out the distinction between:

(1) payment of a share out of profits, *i.e.*, if profits do not arise, no payment shall be made; and

(2) payment of a share out of income where this payment is a dead charge against profit and loss account (*i.e.*, this payment is independent of the assessee's making any profit or not) in order to arrive at the profits.

In this case, the appellants duly earned and received payment from the Tata Power Co., of their commission of 10 per cent. on the net profits of that company and duly paid over to F. E. Dinshaw, Ltd., and to Richard Tilden Smith's administrator, 12½ per cent. thereof each, or 25 per cent. in all. In the High Court, the appellants were unsuccessful to get the deduction of the above amount. The Privy Council observed "In the Pondicherry case, the assessees were under obligation to make over a share of their profits to the French Government. Profits had first to be earned and ascertained before any sharing took place. Here the obligation of the appellants to pay a quarter of the commission which they receive from the Tata Power Co., Ltd., to F. E. Dinshaw, Ltd., and Richard Tilden Smith's administrator is quite independent of whether the appellants make any profits or not. Indeed, if on their year's operations as a whole they were to make a loss and incur no liability to income-tax, they would nevertheless, have to pay away a quarter of the commission in question to the parties named. The commission in truth is not profit or gain: it is only an item or factor in the computation of the appellants' profits or gains. Their Lordships regard this as a fundamental distinction. It was not questioned by Counsel for the Crown that if the present question had arisen with Tata Sons, Ltd., they would under S. 10(2)(ix), have been entitled on the facts stated to deduct their payments to F. E. Dinshaw, etc., as being expenditure incurred solely for the purpose of earning their profits. But he submitted that after the acquisition of the agency business by the present appellants, the payments assumed a different character. The appellants, he said, did not take any part in obtaining the loans nor did they incur the liabilities in question in the course of rendering any services to their principals. The obligation to make the payments in question was taken over by them as part of the transaction whereby they acquired the agency business from Tata Sons, Ltd., and the payments were, therefore, made not for the purpose of earning profits in the conduct of the agency business but in fulfilment of the terms on which they purchased the business. . . The Privy Council decided that the deduction claimed is inadmissible.

In **Madura Hindu Permanent Fund, Ltd. *vs.* C.I.T., 1933, I.T.R. 46, Madras, the assessee** company advanced **loans to members** and paid **guaranteed** interest to sub-

scribers. The fund claimed deduction under section 10(2) (ix). The deduction was allowed. The guaranteed interest was interest earned by the fund and not a return of a surplus arising from an over-estimate. (Style's case did not apply see Life Insurance chapter.)

In the Anglo-Persian Oil Company (India), Ltd case, 1933, I.T.R., 129, it was decided that the sum paid by the company as compensation for loss of agency whereby the company relieved itself of further annual payments of commission chargeable to revenue account should be allowed in the revenue account.

Trade Associations have been brought under assessment where such associations are carrying on some business; those that carry on private clubs for recreation and sports and such other services will not come under the mischief of the law

Insurance Business

THE SCHEDULE

See section 10 (7)

RULES FOR THE COMPUTATION OF THE PROFITS AND GAINS OF INSURANCE BUSINESS

1. In the case of any person who carries on, or at any time in the preceding year carried on, life insurance business, the profits and gains of such person from that business shall be computed separately from his income, profits or gains from any other business.

(2). The profits and gains of life insurance business shall be taken to be either—

(a) the gross external incomings of the preceding year from that business less the management expenses of that year, or

(b) the annual average of the surplus disclosed by the actuarial valuation made for the last inter-valuation period ending before the year for which the assessment is to be made, after adjusting such surplus so as to exclude from it any surplus or deficit included therein which was made in any earlier inter-valuation period and any expenditure other than expenditure

which may under the provisions of section 10 of this Act be allowed for in computing the profits and gains of a business,

whichever is the greater:

Provided that the amount to be allowed as management expenses shall not exceed—

(a) 7½ per cent. of the premiums received during the preceding year in respect of single premium life insurance policies, plus

(b) in respect of the first year's premiums received in respect of other life insurance policies for which the number of annual premiums received is less than twelve, or for which the number of years during which premiums are payable is less than twelve, for each such premium or each such year 7½ per cent. of such first year's premiums received during the preceding year, plus

(c) 85 per cent. of the first year's premiums received during the preceding year in respect of other life insurance policies and 8½ per cent. of other premiums received during that year in respect of all life insurance policies other than single premium life insurance policies.

3. In computing the surplus for the purpose of rule 2,—

(a) one-half of the amounts paid to or reserved for or expended on behalf of policyholders shall be allowed as a deduction:

Provided that in the first such computation made under this rule of any such surplus no account shall be taken of any such amounts to the extent to which they are paid out of or in respect of any surplus brought forward from a previous inter-valuation period:

Provided further that if any amount so reserved for policyholders ceases to be so reserved, and is not paid to or expended on behalf of policyholders, one-half of such amount, if it has been previously allowed as a deduction, shall be treated as part of the surplus for the period in which the said amount ceased to be so reserved;

any amount either written off or reserved in the accounts or through the actuarial valuation balance sheet to meet depreciation of or loss on the realisation of securities or other assets, shall be allowed as a deduction, and any sums taken credit for in the accounts or actuarial valuation balance sheet on account of appreciation of or gains on the realisation of the secuirties or other assets shall be included in the surplus:

Provided that if upon investigation it appears to the Income-tax Officer after consultation with the Superintendent of Insurance that having due regard to the necessity for making reasonable provision for bonuses to participating policyholders and for contingencies, the rate of interest or other factor employed in determining the liability in respect of outstanding policies is materially inconsistent with the valuation of the securities and other assets so as artificially to reduce the surplus, such adjustment shall be made to the allowance for depreciation of, or to the amount to be included in the surplus in respect of appreciation of, such securities and other assets, as shall increase the surplus for the purposes of these rules to a figure which is fair and just;

(c) the whole amount of interest received in respect of any securities of the Central Covernment which have been issued or declared to be income-tax free shall be deducted.

4. Where for any year an assessment is made in accordance with the annual average of a surplus disclosed by a valuation for an inter-valuation period exceeding twelve months, then, in computing the tax payable for that year, credit shall not be given in accordance with sub-section (5) of section 18 for the tax paid in the preceding year, but credit shall be given for the annual average of the income-tax paid by deduction at source from interest on securities or otherwise during such period.

5. For the purposes of these rules—

(i) 'preceding year' means that year for which annual accounts are required to be prepared under the Insurance Act, 1938, immediately preceding the year for which the assessment is to be made or until the

of the Insurance Act 1938, the previous year as defined in section 2 of this Act;

(ii) 'gross external incomings' means the full amount of incomings from interest, dividends, fines and fees and all other incomings from whatever source derived (except premiums received from policyholders and interest and dividends on any annuity fund) and includes also profits from reversions and on the sale or the granting of annuities, but excludes profits on the realisation of securities:

Provided that incomings, including the annual value of the property occupied by the assessee, which but for the provisions of sub-section (7) of section 10 would have been assessable under section 9 shall be computed upon the basis laid down in the last named section, and that there shall be allowed from such gross incomings such deductions as are permissible under that section.

(iii) 'management expenses' means the full amount of expenses (including commissions) incurred exclusively in the management of the business of life insurance, and in the case of a company carrying on other classes of business as well as the business of life insurance in addition thereto a fair proportion of the expenses incurred in the general management of the whole business. Bonuses or other sums paid to or reserved on behalf of policyholders, depreciation of, and losses on the realisation of, securities and any expenditure other than expenditure which may under the provisions of section 10 of this Act be allowed for in computing the profits and gains of a business are not management expenses for the purposes of these rules;

(iv) 'life insurance business' means life insurance business as defined in clause (11) of section 2 of the Insurance Act, 1938;

(v) 'securities' includes stocks and shares.

6. The profits and gains of any business of insurance other than life insurance shall be taken to be the balance of the profits disclosed by the annual accounts, copies of which are required

under the Insurance Act, 1938, to be furnished to the Superintendent of Insurance after adjusting such balance so as to exclude from it any expenditure other than expenditure which may under the provisions of section 10 of this Act be allowed for in computing the profits and gains of a business. Profits and losses on the realisation of investments, and depreciation and appreciation of the value of investment shall be dealt with as provided in rule 3 for the business of life insurance.

7. The profits and gains of companies carrying on dividing society or assessment business shall be taken to be 15 per cent. of the premium income of the previous year, or in the case of non-resident companies 15 per cent. of the British Indian premium income of the previous year.

8. The profits and gains of the British Indian branches of an insurance company not resident in British India, in the absence of more reliable data, may be deemed to be the proportion of the total world income of the company corresponding to the proportion which its British Indian premium income bears to its total premium income. For the purpose of this rule, the total world income of life insurance companies not resident in British India whose profits are periodically ascertained by actuarial valuation shall be computed in the manner laid down in these rules for the computation of the profits and gains of life insurance business carried on in British India.

9. These rules apply to the assessment of the profits of any business of insurance carried on by a mutual insurance company.

Life Insurance Companies (under new Act of 1939).

Definition of "Life Insurance business" is as follows:—

"Life Insurance business includes annuity business that is to say, the business of effecting contracts of Insurance for the granting of annuities on human life and if so provided in the contract of Insurance, disability and double indemnity benefits." [Insurance Act, 1938, Section 2(11).]

(1) Assessment on the greater of the two computations (A) and (B).

(A) Gross External incomings of the preceding year less the management expenses of that year.

"**Gross External incomings**" means the full amount of incomings from interests, and dividends, fines and fees and all other incomings from whatever sources derived (except interest and dividends on any annuity fund) including profits from reversions and sale of annuities but excluding profits on realisation of securities.

Gross External incomings will include income from house property (*i.e.*, rent) for the purpose of assessment but it should be computed under Section 9.

"**Management Expenses**" means an expense normally incurred in life business which includes commissions given but which does not include —

(*i*) bonus and claims to policy-holders.

(*ii*) depreciation or loss on realisation of securities,

(*iii*) any expenditure not provided for under Section 10

The total of management expenses must not exceed

(1) $7\frac{1}{2}$% of single premiums and first year's premiums on policies on which premiums are payable for less than 12 years.

(2) 85% of first year's premiums of other policies.

(3) $8\frac{1}{2}$% of all renewal premiums

NOTE.— "Inter-valuation period" means, as respects any valuation, the period to the valuation date of that valuation from the valuation date of the last preceding valuation in connection with which an abstract was prepared under this Act or under the enactments repealed by this Act, or, in a case where no such valuation has been made in respect of the class of business in question, from the date on which the insurer began to carry on that class of business."

(B) Annual average or actuarial surplus as disclosed by the valuation made for the last intervaluation period ending before the year for which assessment is to be made after excluding from the actuarial surplus any deficit or surplus included therein in any earlier period.

In computing the annual average the following points should be noted :—

(*i*) Half of the bonus allocated to the policyholders is to be allowed as deduction; provided that in the first computation, no deduction will be allowed as bonus allocation to the extent that they are paid out of surplus relating to previous valuation.

Provided further that if any such bonus previously allowed as a deduction is subsequently not paid or expended, it shall be added to the surplus disclosed by the valuation

(*ii*) any deficit or surplus included in the actuarial surplus as per preceding actuarial valuation is to be excluded.

(*iii*) when the valuation period is more than 12 months, credit shall not be given as per section 18(5) for the tax paid but credit shall be given for the annual average of the income-tax paid by deduction at source from interest on securities or otherwise. But credit shall be given as per Section 18(5) when valuation period is 12 months.

(*iv*) Depreciation or loss on realisation of securities or other assets are admissible deductions provided they are written off in the accounts or reserved; similarly, appreciation will be treated as income.

(*v*) The whole amount of interest received on tax-free securities shall be deducted.

(*vi*) If upon consultation with the superintendent of Insurance, the I.T.O. is of opinion that the liability on outstanding policies has been unreasonably over-valued and the assets have been under-valued so to artificially reduce the surplus, the I.T.O. may increase the surplus to a figure fair and just.

(2) Up to March, 1939, the assessment of Life Insurance Companies was based on actuarial surplus. According to the very large volume of opinion in the country this basis was considered to be faulty until a deduction was allowed from it for any payment to the policyholders. Mr Desai, in the Assembly Debates, made the popular point of view clear as below :—

> But at the end of the year they find that events have not turned out as badly as apprehended, that is the number of deaths have not been too many and the income realised was nearly as expected; the result of which is that out of the Rs 5—the difference between the Rs 30 required and the Rs 35 which had been taken or charged as premium a large part is returned to the policyholders which is really their own money and in no sense an income. It is for that reason that it was perfectly obvious that to tax the surplus was entirely a wrong basis for it could not be maintained that the bulk of it was income You merely return to him what you took from him in the first instance A Royal Commission in England examined this matter some years ago and came to the conclusion which I have attempted to express in popular language. They realised that surplus could not be called income; but here the State has got away with it for a long time'

To this Mr Chambers gave a reply which amply illustrated that that interpretation was not fully correct, and that a large portion of the surplus could be assessable income. The following speech of his should be read with interest and profit :

"All insurance matters are worked on averages and let us assume for the sake of discussion that Rs. 75 may be paid for a Rs. 100 dividend and I think actuaries will bear me out when I say that roughly, on most of such policies, the amounts paid are less than sums re-paid on death. The principal reason why they are less is that those premiums earn interest, once they are invested with the company. As they earn interest, the capital sums paid on maturity include an element of income, which income we never tax. That is an important point to remember. They do include an element of income which we have not taxed but in the case of a new company the position is still worse. The interest is relatively small but at the end of the first valuation period it may be found that the surplus which is available for the shareholders, I am talking of the shareholders alone and not the policyholders at the moment, is larger than the interest because the actual mortality experience is less than that provided for in the policy. So that there is a definite surplus available for shareholders which is in excess of interest, whether one deducts expenses or not. For that reason, it would be impossible to say that the only fair and proper basis for assessment of life insurance companies is interest less expenses. We must have some other basis. The other basis is clearly the basis of actuarial valuation and in the past no deduction has been made in India for bonuses to participating policyholders and the official argument in the past has been that as generally speaking the amounts paid to the policyholders exceed the premium paid by the policyholders, then those bonuses have been derived entirely from interest and earnings of the company."

(3) The North British and Mercantile case created some difficulty. Rule 4 refers to that question of allowing credit for the deduction of income-tax under Section 18(5).

(a) In the case of insurance companies whose actuarial valuation covers a period exceeding one year, credit shall be given for the amount of average income-tax deducted at source during the valuation period (not the amount of income tax deducted in the preceding year).

(b) In the case of insurance companies whose actuarial valuation covers a year, credit shall be given under Section 18(5) for the amount of income tax deducted in the preceding year. It is clear that the question of average does not come in as the preceding year is the valuation year

(4) Rule 2, proviso (b), prevents the insurance companies from taking the advantage of an allowance of 85% of first year's premiums as management expenses in respect of short term policies In this connection, Mr K Santhanam said in the Council of State:

"S[illegible] the Bill [illegible] management expenses 85 per cent [illegible] and [illegible] per cent of the renewal premiums [illegible] made an exception in the case of single premiums [illegible] case 7½ per cent is to be allowed [illegible] and 85 per [illegible] temptation on the part [illegible] to create two years or three years [illegible] per cent might be granted [illegible]. It is a loophole for evasion, and I am trying to [illegible]. I hope the House [illegible]

Rule 2 Proviso (b) allows 7½% of first year's premium as management expenses in respect of policies for which the number of annual premiums received is less than 12 or for which the number of years during which premiums are payable is less than 12

The percentage allowed on the first year's premium arising from this class of short term or limited payment policies is the same as single premiums In actual practice, the incidence of expenses is much higher and the allowance on renewal premium has been omitted.

(5) Income from rent

If Section 10(7) had not been introduced in the new

Act, income from house property of an Insurance Company would have been assessed under Section 9.

In the presence of Section 10(7), this income would come under the Schedule. But as it comes under the Schedule, the usual deductions from property income cannot be claimed unless specially provided for.

As the Legislature desired to keep the income under the schedule and also get the deductions in spite of that, the rule 5(*ii*) proviso provides :

(1) that for the purposes of *Computation*, the property income should be under Section 9 and get the allowances.

(2) that for the purposes of *Assessment* the property income should come under External earnings after being computed as above.

(3) that in "external earnings", the annual value of the property occupied by the assessee shall be included as against rent (equivalent to annual values) which have been allowed as a deduction in the Management Expenses.

In this connection Mr. Chambers said:

"The reason for this proviso of clause (ii) of Rule 5 is that the profits of Life Insurance Companies from whatever source they are obtained, including profits from property owned, are to be computed in accordance with these rules and not in accordance with the rules in the various Sections under which they would otherwise have been computed. Now in a case of the income from property it is suggested that we should continue to assess them according to the rules of Section 9 but to include them in the profits under these Rules, and that is considered to be quite an equitable arrangement and I think it was the intention when the original rules were drafted that that should be done. This certainly makes the matter absolutely clear."

(6) As regards management expenses, the Act has allowed a maximum of 8½% of renewal premium income

and 85% of new premium income on the basis that the incidence of expenditure on new business is 10 times that on renewals.

While the ratio of 10 :1 is quite an accepted standard regarding the comparative strain of expenses in new and renewal business, the percentages (*viz*., 8½ and 85) are much lower than those actually experienced by most of the larger Indian and British Insurance Companies.

(7) "If that is done, then, the liabilities are overstated relatively to the assets, and we get either a deficit, when there should be a surplus, or a much smaller surplus than is in fact warranted. Now the intention of this proviso is to guard against such uses and all it does is to say that where the Income-tax Officer finds that the liability has been stated on a basis which is materially inconsistent with the basis on which the securities have been valued, then we would have the power to make such adjustment to the depreciation or appreciation of securities as is fair and just."

The above observations of Mr Chambers are hardly sufficient to meet the public criticism that while on one hand, the Actuaries are strongly inclined to make a valuation on as conservative a basis as possible in order to ensure financial stability, the Income-Tax Act on the other hand, by this proviso, empowers the Income-Tax Officer to resist such a wholesome principle of conservative valuation Section 22 of the Insurance Act 1938, empowers the superintendent of Insurance to revise the valuation when he considers it advisable

"If it appears to the Superintendent of Insurance that an investigation or valuation to which section 13 refers does not properly indicate the condition of the affairs of the insurer by reason of the faulty basis adopted in the valuation, he may, after giving notice to the insurer and giving him an opportunity to be heard, cause an investigation and valuation to be made at the expense of the insurer by an actuary appointed by the insurer for this purpose and approved by the Superintendent of Insurance."

This provision of the Income-Tax Act is therefore unsound and unfair to the Insurance Companies. Any basis, however rigorous, once approved by the Government of India Actuary, ought to be accepted for all purposes by all concerned. The Income Tax Act provides otherwise and the Act in saddling the Income Tax Officer with this onerous duty has been unjust to the companies and also to the Income Tax Officers who, by no stretch of imagination, can be supposed to be expert in such a specialised and technical branch of study. The law should be that once the valuation report is examined and passed by the Superintendent, it should form the basis of assessment. This proviso refers to the disparity between the two bases adopted in the valuation and the reference seems to be unfortunate, because, unquestionably, the duty lies with the Superintendent of Insurance to see to that point before the valuation report is accepted by him for the Government of India.

NOTE.—*Reversion*, in Executorship Law, refers to the Residue of an Estate after a particular portion, less than the whole Estate, has been granted to another person by the owner. Reversioner is entitled, after the death of the present life tenant, to the income for life or he may be entitled to the capital of the fund. Insurance Companies advance loans on reversions. These mortgages on reversions carry higher rate of interest and these securities are avoided by trustees and the bulk of private lenders, for, there is no immediate income and also because they require special skill to guard against a number of risks.

Reversionary bonus.—After the actuarial valuation, the surplus is divided between the policyholders and the shareholders. The bonus to the former payable on maturity of the policies is called reversionary bonus. The other bonus is cash bonus.

Illustration 53.

From the quinquennial report of the valuation of the Liabilities and Assets of the Oudh Insurance Co., Ltd.,

Lucknow, as on 31st December, 1935, the following extract is taken:

The Valuation Balance Sheet is as follows:—

	Rs		Rs
Net liability under Life Assurance transactions	2,27,70,645	Funds as per Balance Sheet	2,52,84,292
Surplus	25,13,647		
	2,52,84,292		2,52,84,292

The total surplus emerging during the quinquennium inclusive of the sum of Rs 30,824 brought forward from the last valuation comes to i.e. Rs 25,13,647. Of the Government of India securities Rs 3,30,251 are free of tax. The valuation has disclosed a surplus which is recommended for distribution as follows:

Shareholders	Rs 1,25,680 (say 5% of the surplus)
Policy holders	Rs 23,05,143
Carry forward	Rs 82,824
	Rs 25,13,647

CONSOLIDATED REVENUE ACCOUNT FOR 5 YEARS COMMENCING 1ST JANUARY AND ENDING 31ST DECEMBER

Income		Rs	Expenditure	Rs
Life fund (beginning)		7,45,87,931	Claims	80,00,000
Premium		2,04,63,605	Surrenders	12,00,000
Interest and Dividends	45,00,000		Expenses of management	50,00,000
Rents	5,56,856		Income-tax and S.T.	2,06,770
Less I. T.	4,17,330		Life fund (closing)	8,52,84,292
		46,39,526		
		9,96,91,062		9,96,91,062

Solution.

(1) Method employed before 1939 Amendment.

Assessment 1936-37.		Rs.
Surplus as per report		25,13,647
Less balance brought forward from previous valuation		30,824
		24,82,823
Add income-tax on interest and dividends	Rs. 4,17,330	
Add income-tax and Super-tax	Rs 2,06,770	
	6,24,100	
		6,24,100
		31,06,923

Rs 31,06,923 ÷ 5 = Rs. 6,21,385 being the annual average profit for I T. purposes

(2) Method employed after amendment of 1939.

Computation A (Income basis)

	Rs
Gross Ext. incomings	19,00,000
Less management exp. (not exceeding the detailed amounts specified in (a), (b) and (c) under the proviso to rule 2 of the Schedule)	20,00,000
Loss	1,00,000

Note —house rent included is Rs 4,00,000 after allowing deductions under Section 9

Computation B (Surplus basis)

	Rs
Actual surplus	25,13,647
Less balance b f	30,824
	24,82,823
Less half the amount of bonus reserved for policy holders	11,52,572
	13,30,251
Less interest on income-tax-free Government of India securities	3,30,251
	10,00,000

10,00,000 ÷ 5 = Rs. 2,00,000 being the annual average profit for I T purposes.

Final result.—Therefore Computation B will be the basis of assessment.

Illustration 54.

WESTERN INDIA MARINE INSURANCE, CO., LTD.*

Revenue A/c. for the year ending

	Rs.	a.	p.		Rs.	a.	p.
Net premiums	7,25,000	0	0	Losses less Salvage	2,70,000	0	0
Interest	2,15,000	0	0	Commission	1,20,000	0	0
Transfer fees	250	0	0	Charges General	2,10,000	0	0
				Surplus transferred to P. & L. A/c	3,40,250	0	0
	9,40,250	0	0		9,40,250	0	0

P. and L. Account

	Rs.		Rs.
Dividend of 10% declared	2,00,000	By balance brought forward from the previous year	2,45,000
Balance c/d	45,000		
	2,45,000		2,45,000
Income-tax & Super tax	20,000	By balance brought down	45,000
Underwriting Suspense A/c	1,00,000	By surplus transferred from Revenue A/c	3,40,250
Balance as per B.S.	2,65,250		
	3,85,250		3,85,250

Solution

Analysis of Interest Rs. 2,15,000	Rs.
(1) Interest on taxed securities (Net)	12,260
Interest on tax free securities	1,63,000
	1,75,260
(2) Interest earned outside British India and not brought in	40,350
	2,15,610
(3) Less Interest paid	610
	2,15,000

*Non-Resident Company carrying on business in British India.

		Rs.
Surplus as per Revenue A/c ...		3,40,250
Less Interest earned out-side British India ...		40,350
		2,99,900
Less Underwriting Suspense Account		1,00,000
		1,99,900
Less Interest on securities		1,75,260
Business income		24,640
Interest on securities	1,75,260	
I. T. on securities	2,270	
		1,77,530
Total Income		2,02,170

Further Income-tax now payable : on Rs. 24,640 at 30 pies per rupee = Rs. 3,850.

NOTE.—Taxable securities have already been taxed at the highest rate of 30 pies.

SUPER TAX

Total income	Rs. 2,02,170
Therefore Super-tax = Rs.	Rs. 12,635-10

Up to March 1939, the actuarial surplus was the basis for assessment to income tax of Life Insurance companies. The annual average of this surplus was to be found out. This was the method which followed from the rules 25 to 30 (now omitted). By the Amendment Act of 1939, this basis of assessment has undergone extensive modifications.

In the first edition, the author gave an illustration of a hypothetical working as below :—

Life assurance fund on 31. 12. 25	... Rs. 2,45,000
Less liabilities under Life Assurance transactions on 31. 12. 25	... Rs. 3,45,000
Deficiency	... Rs. 1,00,000
Life Assurance fund on 31. 12. 30	... Rs. 4,70,000
Less liabilities under Life Assurance transactions on 31 12 30	.. Rs. 5,30,000
Deficiency	.. Rs. 60,000

In the assessment of 1931 32 the Life Company claims that it has made a loss of Rs 12,000 being the annual average on Rs 60,000.

The Income tax Authorities on the contrary take the view that the deficiency on 31st December, 1925, of Rs 1,00,000 is reduced to Rs 60,000 on 31st December, 1930, which means that there must have been profits of Rs 40,000 during 1925 to 1930, which alone could have reduced the deficit Hence, the annual average would be Rs 8,000 profits

Therefore, Company's contention is loss of Rs. 12,000

Income tax Department's contention is profit of . ... Rs 8,000

The problem was whether such a contention of the Income tax Department could be justified. To what extent did this method follow from the rules?

An exactly similar case has been decided by the Calcutta High Court and by the Privy Council in 1939 (C.I.T. Bengal *vs.* Himalya Assurance Co., Ltd., 1939, I.T.R. 402).

The following question was referred to the High Court :—

"The assessee's actuarial valuation balance sheet on the last date of the last preceding valuation having shown a deficiency, does the provision of Rule 25 of the rules under the Income-tax Act for ascertaining the average annual net profits of a Life Assurance Company permit the department to go behind the said valuation balance sheet to find out if there were any profits in respect of the period of the last preceding valuation?"

The High Court answered it in the negative and the Privy Council upheld the decision relying on the interpretation of rule 25 as given in Bharat Insurance Case. In discussing Rule 25 Lord Romer observed

—"It is plain that the balance-sheet will merely show the financial position of the company at the end of the period and that the surplus or deficiency disclosed by it will not necessarily be the result of its business transactions during the period In order to ascertain the result of those business transactions it will be necessary to compare the surplus or deficiency with the surplus or deficiency disclosed by the valuation balance sheet drawn up at the end of the preceding period In the case, for instance, of a company like the respondent company whose financial condition is ascertained once in every 5 years, there may be a surplus disclosed at the end of the first quinquennium of the company's trading The surplus will, of course, represent the profit made during such quinquennium and the life assurance fund at its end will be swollen by the amount of such profit But if that profit be not wholly distributed amongst the shareholders or participating policy-holders during the succeeding quinquennium, the life assurance fund at the end of this second quinquennium will be swollen by the amount of that profit which remains undistributed and to that extent will increase the surplus or diminish the deficiency, as the case may be, that is disclosed by the second valuation balance-sheet. It is this consideration that gives rise to the difficulty occasioned by the terms of Rule 25".

In the English case, Last *vs*. London Assurance Corporation (1886, 10 A.C. 438) it was held that the distribu-

tion of bonus was an appropriation of profits and not an expenditure for earning the profits.

In Bharat Insurance Co., Ltd. *vs.* C.I.T., Punjab (1934, I.T.R. 63), the Company showed a surplus of about rupees six lacs according to actuarial valuation. According to agreement, 90% of the surplus was to go to the participating policyholders. It was contended by the company that this 90% should be allowed as a deduction from the surplus and then one-fifth is to be assessed. The High Court disallowed this contention. The Privy Council upheld the High Court.

Regarding Rule 25, the Privy Council observed : "The net profits in this rule clearly mean the 'surplus if any' in the statutory form of valuation Balance-sheet set out above of 'Life assurance and annuity funds' over the net liability under life assurance and annuity transactions."

In the opinion of the C.I.T :

The result of the actuarial valuation of a life assurance company as disclosed in the actuarial accounts at the end of a given period is really a continuation of previous valuation, and adjustment must necessarily be made to find out what really is the surplus or deficit of a given period (in this case a quinquennium) in order to determine the assessability or otherwise of the Company in terms of Rule 25. If the result of the valuation of a period preceding the period, which is made the basis of an assessment is a surplus, such portion of that surplus as has not been appropriated by way of bonus, etc., automatically comes to be merged in a subsequent valuation and, unless such unappropriated surplus is taken out of the next valuation results, there will obviously be double taxation of some income. Similarly, if the result of the valuation of a period preceding the valuation which is made the basis of assessment of a given year is a deficit, such deficit will automatically find its way into the next valuation. To arrive at the annual average net profit, adjustment will therefore have to be made to avoid the results as above stated and such adjustment is accordingly permissible by Rule 25 . . . . . I would respectfully submit that the actuarial valuation (i.e., the valuation balance-sheet

as at February 28, 1935 in this case), really disclosed a positive surplus".

A case of interest to the Life Insurance Companies was, in 1937, decided by the Calcutta High Court, *viz.*, the case of North British and Mercantile Insurance Co., Ltd. *vs.* C.I.T., Bengal, 1937, I.T.R. 349.

Three questions emerged from the case:—

(1) Where income-tax is charged on the income of an Insurance Company as per rules made (rules 25 to 35), whether the Company can claim credit under section 18(5) of the Act for any deduction of tax made at the source.

(2) When profits of an Insurance Company are computed as per rules made (rules 25 to 35) whether the Company is entitled to claim that from the amount thus computed the amount of income of the Company in respect of interest on tax-free securities can be deducted in computing the assessable income.

(3) Whether for correction of rate of income-tax the Income-tax Officer has any jurisdiction to reopen assessment under section 34 or to reassess at a higher rate than the one previously adopted.

Whether the Assistant Commissioner has jurisdiction to enhance the said assessment.

With regard to the first question, all the judges agreed that the Company can claim credit under section 18(5) for any deduction of tax on interest on securities made at source.

With regard to the second question, Derbyshire C.J. and Costello J. agreed that the Company is entitled to claim that from the amount ascertained according to rules 25 to 35, the amount of the income of the Company in respect of the interest on tax-free securities shall be deducted in computing the assessable income.

Panckridge J. dissented. He observed: "It follows that before the assessees can complain that the assessment violates 2nd proviso to section 8, they must show that the tax demanded is being demanded in respect of income, profits and gains which are

covered by the section as being interest on securities. In my judgment, the assesees have failed to establish this. What is to be assessed to tax is the annual average net profits disclosed by the last preceding valuation with the additions provided for by rule 25."

In this particular issue, the Commissioner made some very clear, helpful and able observations. He says: "As regards the determination of the assessable income the rule is empirical and helps us to arrive only at a "notional figure" not necessarily the actual figure of any particular year. In my opinion this figure does not refer to any particular source or sources as contemplated by section 6 of the Act and does not admit of any dissection or analysis. . . . These rules are intended to be self-contained provisions for assessment of Insurance Companies and to a case where these rules will apply the provisions contained in sections 6 to 12 shall have no application. That this is the intention of the law will be evident from rule 30, which provides for allowing depreciation on assets (otherwise allowable under section 10) and losses which are not ordinarily allowed."

With regard to the third question Panckridge J. said: "There is more to be said for the argument that when what is appealed against is an assessment or reassessment under section 34 the Assistant Commissioner is bound to confine himself to what is covered by such assessment or reassessment and cannot deal with matters covered by a previous assessment made under section 23. I prefer to base my decision that the Assistant Commissioner had no power in this case to enhance on the ground that the reassessment under section 34 was on the face of it without jurisdiction and as such should have been annulled with the result that the original assessment under section 23 would have stood."

By the new Amendment Act of 1939, the above decision of North British Company has become inoperative. Rule 4 of the Schedule meets the point.

MUTUAL INSURANCE COMPANY

Before the new Amendment Act of 1939 came into operation, the Mutual Insurance Companies' surpluses were exempt from the tax. But now it has been specifi-

cally provided that the profits of a mutual insurance company are assessable like other insurance companies. In this connection, the definition of 'income' in Section 2, is worthy of special notice as the definition now covers these surpluses.

In the case of Madura Hindu Permanent Fund, Ltd. *vs.* C.I.T., Madras 1933, I T R 46 and Millowners' Mutual Insurance *vs.* C.I T, Bombay, 1932, 58 Bombay, 119, the profits were exempt.

In the case of National Mutual Life Association a portion was exempt If such a "fund" or business makes income from interests, etc, received from outsiders, the income will evidently be assessable

In the English case, Styles *vs.* New York Life Insurance Co (2 Tax cases 460), the surplus which was distributed between the participating policy-holders consisted of

(1) Sale of life annuities,

(2) profits arising out of business carried on with non-members,

(3) excess premiums paid by participating policy-holders over the cost of their insurances,

(4) profits arising out of non-participating policies, also it was decided that the surplus arising from the excess premiums paid by participating policy holders is not profit liable to tax

In the case C I T, Bombay, *vs.* National Mutual Life Association, 1933 I T R 350, decided by the Bombay High Court and later on finally decided by the Privy Council (1936, I T R 44, P. C.), the Head Office of the Company is in Melbourne (Australia) Branches in India—Calcutta and Bombay Company is limited by guarantee and has no share capital Every person who insures his life with the Company under a participating policy is deemed to have become a member of the Company. The surplus profit is distributed amongst the members The Company's Articles provide that triennial actuarial valuation is made by the Actuary for all its business and the surplus profits for three years thus ascertained are distributed amongst the participating policy-holders. The Company while making a return of its income

from its British Indian business for the accounting year submitted with the return a revenue account and balance-sheet for that year. The Income-tax Officer in assessing under section 23(4) proceeded under rule 35 but ignoring altogether the principle of Style's case, made a calculation entirely ignoring the non-participating premiums received, including the whole amount of consideration received in respect of annuities, deducting nothing in respect of their or in respect of the Company's liabilities or expenses of non-participating business.

The Privy Council decided that—

(1) Income-tax Officer was justified in resorting to rule 35 (*now stands omitted by the new Act of 1939*) and therefore computation on the basis of the triennial valuation reports was the most reliable method of computation in the case of Life Insurance Companies. Here the right of the Income-tax Officer was established

(2) The assessment was not valid or legal assessment inasmuch as the total income, profits or gains of the Companies referred to in rule 35 was the income, profits or gains as they would be ascertained for the purpose of the Act and even accepting the contention of the Bombay High Court that the premium income referred to in rule 35 includes premiums received in respect of participating policies, the total income referred to was the incomes and gains as ascertained for the purposes of the Act In other words, in calculating such incomes for rule 35, the premiums received from participating policies should be excluded (as per Style's case).

NOTE.—The Central Board of Revenue accepted that Style's case applies in India.

Applying rule 35, I T O assessed the company as follows:—

(1) Premiums of the Company as a whole for the year ended 30-9-30 £ 3,244,476

(2) Premiums of the Company in British India for the same period £ 87,942

(3) Net assessable profit of the Company as a whole based on the triennial investigations as at 30. 9. 28. £ 1,405,027

Proportionately, profit of British India (converted in Indian Currency—Rs. 5,14,020.) £ 38,083

Millowners' Mutual Insurance Association *vs.* C.I.T., Bombay, 1932, 58, Bombay, 119. This Mutual Insurance Company was limited by guarantee without any share capital. Articles provided ascertainment of profits after 3 years but profits to be distributed to only such members as would be enrolled during the first 2 years. It was decided that the surplus of the calls, premiums or any further sum received by the Company from its members *over* its expenditure for the year, was not assessable to tax under the Act.

In Lakshmi Insurance Co. *vs* C.I.T., Punjab, 5 I.T.C, 24, it was decided that no assessment can be made until the first valuation has been made.

RULE 7.—The profits and gains of companies carrying on dividing society or assessment business shall be taken to be 15 per cent. of the premium income of the previous year, or in the case of non-resident companies 15 per cent of the British Indian premium income of the previous year (Schedule)

A company which carries on a form of insurance business under which the policy money payable on the happening of the contingency insured against is not fixed but depends either partly or wholly on the results of the division of any portion of the premium income or funds among the policies which have become due for payment in proportion to the premiums received under each class in the specified period, carries on a dividing society business within the meaning of Rule 31 of the Income-Tax Rules and its income, profits and gains can be ascertained under that Rule. The fact that the Rules provide that the amounts payable fall within certain limits does not affect their variable and contingent nature where the payment ultimately depends on the total amount of subscriptions and the total annual claims. Where the shareholders and the policy-holders are not the same, a company carrying on such business is not a mutual society and its income is not exempt from tax on that account. The fact that the subscribed capital is very small compared with the premium income does not make any difference. (C.I.T., Bombay, *vs.* Sindh Central Provident Funds Society, Ltd. 1939, I.T.R. 333.).

TEA COMPANY

Crop and Revenue account for the period 1. 1. 1935 to 31. 12. 1935.

Illustration 55.

To cost of production:	£		£
Cultivation	2,400	By Tea sale	19,87[illegible]
Manure	1,600		
Crop Expenses	2,000		
Tea chests	1,800		
European Establishment	3,000		
Indian Establishment	1,600		
Stores and Implements	600		
Livestock and Motor transport	575		
Buildings*	51		
Roads and bridges	125		
General charges	340		
Land Rent	18		
Law charges in India	1[illegible]		
Coolie expenses	280		
Insurance of Factory buildings	150		
Loss of Profit Insurance	272		
*Machinery	42		
Manager's Commission	750		
Exchange	[illegible]		
Crop rights	400		
Brokerage and Sale Expenses in India	630		
Freight up to Calcutta	320		
London charges.			
Freight	2,020		
Dock charges	360		
Insurance Marine	90		
Brokerage and sale expenses	1,050		

* The two items Buildings and Machinery have been found to be capital expenditure

Agent's allowances and commission	1,200		
Office expenses ..	600		
Directors' Remuneration	300		
Profit	26,917		
	49,872		49,872

Profit and Loss Account

To Balance transferred to Balance Sheet	£27,767	By Profit on Crop A/c	£26,917
		Interest in U K £600	
		Interest in India £250	£850
	£27,767		£27,767

Solution.

Incometax.

Profit as per crop account		£26,917
Add back New buildings	£81	
New Machinery	£12	£93
		£27,010
Add Interest in India ..		£250
		£27,260

£27,260 to be converted into rupees at the rate of 1s. 6d

∴ Rs 3,63,467

40% of Rs. 3,63,467 = Rs 1,45,387 is liable to tax.

Income-tax at 30 pies on Rs. 1,45,387	Rs. 22,716-12-0
Super-tax at 12 pies on Rs. 1,45,387	Rs. 9,086-11-0

Note:—

(1) Where tea seed is produced for the assessee it will be included in the profits.

(2) Where tea seed is sold to a third party no tax will be levied.

(3) The whole cost of up-keep of extensions of the Estate which are not in bearing will be allowed as expense, *e.g.*, weeding, draining.

(4) Capital Expenditure, *e.g.*, acquisition, clearing and draining of the land, making of roads, erection of buildings before cultivation begins are not allowed as a charge against profits.

(5) When planting is completed, the annual cost of up-keep of such extension should be allowed.

(6) Expenditure on the maintenance of an area that has not reached maturity is a Revenue Expenditure.

(7) Any expenditure that creates a potential source of recurring revenue at whatever stage in the development of Estate is Capital Expenditure.

Tea bushes are potential sources of revenue.

(8) The cost of planting bushes in replacement of bushes that have died or become permanently useless in an area already planted will be allowed as expense.

If an assessee gets dividend from a Tea Company (limited) of Rs 3,400, his gross income is Rs. 3,932-8-6. While the Tea Company pays Income-tax on profits derived partly from Agriculture and partly from industry and therefore a percentage (40%), according to rule, will be taxed, it must be remembered that an individual should be taxed on his entire receipt, *i.e.*, 100% from investment - no matter whether it is Tea or Sugar or any other industry (though present practice is different).

Illustration 56.

STERLING INSURANCE COMPANY WTH BRANCH IN INDIA

Devonshire Life Assurance Co., Ltd., has a surplus of £1,500,000 as per its annual valuation report inclusive of

£300,000 brought forward from previous year. Out of this amount the Company appropriates £100,000 to Investment Revenue Fund. The following is the Revenue Account after incorporation of the branch profits.

Revenue Account.

		£		£	£
Life Assurance Fund		1,566,626	Claims—		
Premiums		5,400,000	By death	2,370,000	
Interest Divs.			By maturity	2,290,000	
and Rent	1,200,000				4,660,000
Less Income-tax thereon	250,000		Surrenders ..		908,099
		950,000	Expenses of management		730,000
Fines and fees		501	Commission		10,000
			Annuities		3,048
			Fund at the end of the year		1,6[illegible],[illegible]20
		7,9[illegible]			7,9[illegible]

Solution.

Surplus as per actuarial valuation		1,500,000
Less balance brought forward from previous year		300,000
		1,200,000
Less Transfer to Investment Revenue Fund as per report		100,000
		1,100,000
Add Income-tax on Interest Divs. & Rents		250,000
		1,350,000

1. Total world premium 5,400,000
   of which Indian Premium (say) 10,800
2. Total valuation surplus being £1,350,000

find out the Indian surplus (profits for Income-tax purposes) from £1,350,000 in the proportion disclosed by item (1) above.

Indian profit would thus be £2,700.

Rate of conversion being 1s. 6d. to the rupee,

£2,700 = Rs. 36,000.

Rs. 36,000 is the Total Income.

	Rs.
Income-tax at 30 pies on Rs. 36,000	5,625-0-0
Super-tax at 12 pies on Rs. 36,000	2,250-0-0

Illustration 57.

From the following particulars find out I. T. payable:—

	Rs.	a.	p.
(1) Salary per month	250	0	0
(2) Grocery profit as per P. & L. A/c	780	0	0
(3) Property—annual letting value	1,500	0	0
(4) U. P. Trading Co., Ltd., declared 6% dividends free of tax on	14,500	0	0
(5) 5% War Loan free of tax on	3,500	0	0
(6) 7% War Bonds on	1,000	0	0
(7) The assessee pays Life Insurance premium annually	1,450	0	0

Statement of Total Income.

	Particulars	Gross Income	Tax deducted or paid
1	Salary	3,000-0-0	70-5-0
2	Grocery	780-0-0	
3	Property Rs. 1,500 Repairs 1/6 Rs. 250	1,250-0-0	
4	6% on Rs. 14,500 (I. T.)	1,031-1-0	161-1-0
5	5% on Rs. 3,500 (I. T.)	175-0-0	
6	7% on Rs. 1,000 (I. T.)	70-0-0	11-0-0
	Total Income	[illegible]06-1-0	242-6-0

Average rate	8·10 pies		
Tax due			
1st 1,500	Nil		
Next 3,500 @ 9 pies	164 1 0		
Next 1,306 @ 15 pies	102 1 0		
			266 2 0
Less L.I.P. 1/6 of 6,306	1,051	@ 8·10	
Less F. T. Income	175		
	Rs. 1,226		51 12 0
			214 6 0

Tax deducted . . . Rs 242-6-0
Tax due . . . Rs 214-6-0

Rs 28-0-0
Refundable

Illustration 58

From the following particulars find out Income-tax payable by A:—

(*a*) Income from 4% War Bonds (tax-free)	Rs. 3,400
(*b*) Interest from Bank deposit	Rs 500
(*c*) Dividends from R. N. Co., Ltd. 9% (less tax)	Rs 9,918
(*d*) Director's fees (gross) received	Rs 1,000
(*e*) Profits (agreed with I.T.O.) from a registered Firm . . .	Rs. 700
(*f*) Dividends from A.B.C. Co., Ltd., 7%, (tax-free)	Rs. 2,987
(*g*) Profit from an unregistered Firm representing ½ share (agreed with I.T.O.)	Rs. 600
(*h*) Salary as Secretary per month ..	Rs. 200
(*i*) He pays Life Insurance premium annually	Rs. 4,200
(*j*) Income from 5% War Loan (less tax) ...	Rs. 754

Statement of Total Income.

Particulars.		Gross Income	Tax deducted or paid.
(a) 4% War Bonds (tax-free)	..	3,400	
(b) Interest from Bank deposit	...	500	
(c) Dividends from R. N. Co., Ltd. 9% (L.T.)	...	11,754-10-0	1,836-10-0
(d) Director's fees	...	1,000	
(e) Registered firm profits		700	
(f) Dividends A.B.C. Co., Ltd 7% (F.T.)		3,540-2-0	553-2-0
(g) Unregistered firm ½ share		600	
(h) Secretary Rs. 200 p.m.		2,400	42-3-0
(i) 5% War Loan (L.T.)	.	893-10-0	139-10-0
Total Income	.	24,788-6-0	2,571-9-0

Average rate 20·98p.

Tax due

Tax on Rs. 24,788 @ 20·98 pies		2,709-1-0	
Less L.I.P.	4,131		
Less War Bonds F.T. @ 20·98	3,400	822-15-0	
	7,531		1,886-2-0
			685-7-0 (Refundable)

Illustration 59.

From the following particulars, find out the Income-tax payable by A for the year 1939-40:—

(a) Profits from an unregistered firm representing half share, Rs. 750.

(b) Postal Cash Certificate income of Rs. 600.

(c) 6% War Bonds (free of tax) to the value of Rs. 20,000.

(d) Shares in Dacca Central Bank, Ltd., to the value of Rs. 5,000.

The bank declared a dividend of 15% (free of tax).

(e) Shares in Narayanganj Jute Mills, Ltd., to the value of Rs. 5,000.

The Jute Mill declared a dividend of 10% (less tax).

(f) His life insurance premium amounts to Rs. 500 yearly.

Statement of Total Income.

Particulars.	Gross Income.	Tax deducted or paid.
1. Unregistered firm	750-0-0	
2. Postal Cash Certificate Income	*	
3. 6% War Bonds (F.T.)	1,200-0-0	
4. Bank shares (750 + 1/4.)	888-14-0	138-14-0
5. Jute Mills shares	500-0-0	78-2-0
Total Income	3,338-14-0	217-0-0

Average rate 4.96p.

Tax due

1st 1,500	nil	86-3-0	
Next 1839 @ 9 pies	86-3-0		
Less L.I.P. 500	@ 4.96	43-14-0	
" F.T. Income 1,200			
		42-5-0	42-5-0
			174-11-0 (Refundable)

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* Postal Cash certificate is neither taxable nor to be included in the total income. For 1939-40, assessment cannot be on the basis of the new Act (Slab system) in view of sec. 4 of the Indian Finance Act, 1939:—

Notwithstanding anything contained in sub-sec. (1) or ss. (2), where more than half of the total income of any individual or H. U. F. consists of income from salaries, interest on securities or dividends in respect of which the individual or the H. U. F. is deemed. . . .

Illustration 60.

NAROTTAM DAS, SHAREBROKER, CALCUTTA

Revenue and Profit and Loss Account.

	Rs.		Rs.
Establishment	13,040	Brokerage	45,000
Bonus to staff	1,500	Directors' fees	2,000
Depreciation:		Directors' Commission	3,000
Office cars Rs. 400		Dividends	5,974
Furniture Rs. 200		Interest:—	
	600	Govt. Securities,	
Taxi hire, tram, etc.	300	Bonds	1,508
Law charges	250	Debentures, etc.	908
Auditors' fees	550	Interest on balances of	
Membership of the		partners 400	
Calcutta Stock Ex-		Interest allow-	
change Association	500	ed by Bank 500	
Subscription	50		900
Telegrams	800		
Advertisements	300		
Medical expenses	250		
Office car upkeep	1,000		
Telephone	400		
Electric charges	150		
Books and papers	600		
Stationery and printing	450		
Weekly share market report	150		
Stamps and postage	450		
Contract stamps	200		
Office rent	3,000		
Donation	50		
Tiffin expenses	400		
Calcutta money market report	100		
Commission to under-brokers	600		
Retired partners' allowance	5,000		
Net profit	28,600		
	59,290		59,290

Revenue and P. & L. Adjustment Account.

To Directors' fees ..	2,000	By Net Profit	28,600
,, Directors' commission	3,000	,, Depreciation	600
,, Dividends	5,974	,, Donation	50
,, Interest on Debentures	2,416	,, Proprietor's tiffin	200
,, Adjusted profits	21,060	,, Retired partner's allowance	5,000
	34,450		34,450

Business Income as adjusted	21,060
Less Depreciation	500
	20,560

Statement of Total Income.

Particulars	Gross	Tax paid
	Rs	Rs
Business	20,560-0-0	
Interest on Debentures	2,863-6-0	447-6-0
Directors' fees	2,000-0-0	
Directors' commission	3,000-0-0	
Dividends	7,080-0-0	1,106-0-0
Royalties	1,696-10-0	
Total Income	37,200-0-0	1,553-6-0

Average rate @ 23.99 pies
Tax due

Tax on Rs 37,200 @ 23.99 p	4,648-1-0	4,648-1-0
	Still to pay	3,094-11-0

Note :—

(1) The procedure in the Income-tax department is to write back depreciation claimed and then to allow depreciation according to the scheduled rate as per a running statement maintained by the Department.

Depreciation on office car is allowed.

(2) Law charges have been accepted by the I.T.O. as revenue expenditure.

(3) Membership fee paid to the association of the Assessee's own profession is an essential charge in P & L. A/c.

(4) Advertisements made in respect of sale of shares etc., are allowed.

(5) Car up keep (i.e., cost of running and maintenance) is allowed

(6) Books and papers in connection with professional work when replaced are allowed

(7) Retired partner's allowance is not allowed.

(8) Fees and Commissions earned by the assessee as Director of other Companies should be separated from the business income.

Illustration 61

From the following particulars, find out the Income-tax payable by A.—

(*a*) Profits from an unregistered firm representing half share, Rs. 750.

(*b*) Postal Cash Certificates to the value of Rs. 10,000 yielding (say) interest of 3%.

(*c*) 6% War Bonds (free of tax) of Rs. 20,000.

(*d*) Shares in Delhi Central Bank, Ltd., to the value of Rs. 20,250 The Bank declared a dividend of 4% (Free of tax).

(*e*) Sitalpore Sugar Mills, Ltd., declared 8% dividend on Rs. 7,000.

(*f*) Rent of paddy land received Rs. 300.

(*g*) His Life Insurance premium amounts to Rs. 500 yearly.

Statement of Total Income.

Particulars.	Gross.	Tax deducted.
	Rs.	Rs.
*(1) Profits from unregistered firm	750	...
(2) Yield of Postal Cash Certificates ..	Nil	.
(3) 6% War Bonds (Tax free)	1,200	..
(4) Delhi Bank Dividend 4% (Free of tax) on Rs. 20,250	960	150-0-0
(5) Sugar Mill Div. @ 8% (L.T.) on Rs. 7,000	560	87-8-0
(6) Rent of paddy land .	Nil	...
Total Income	3,470	237-8-0

Average rate @ 5·11 pies

Tax due			
Tax on total Income of Rs. 3,470 @ 5·11 ...		92-6-0	
Less L.I.P. 500, F. T. Bonds 1,200	@ 5·11	45-3-	47-2-1
			190-5-11 (Refundable)

* As firm has not been taxed owing to the fact that the Total Income was below Rs. 2,000 the amount Rs. 750 will be taxed here.

Illustration 62.

OUDH BANK, [illegible].

Profit & Loss Account for the period ending.........

	Rs.		Rs.
To Interest paid to depositors ...	30,500	By interest on over-draft	2,900
,, Postage ..	1,500	,, Interest on loan	35,500
,, Advertisement ...	600	,, Interest on G.P. Notes ..	10,500
,, Travelling	750	,, Dividend on shares .	8,300
,, Printing .	450	,, Profit on sale of G.P. Notes and shares ...	3,300
,, Motor expenses	1,200	,, Discount ..	2,000
,, Miscellaneous	500	,, Commission .	1,700
,, Office expenses including rent, electricity, etc ..	8,550	,, Collection charges	1,600
,, Loss on sale of Securities	200	,, Incidental charges	620
,, Insurance premium	300	,, Admission fee ..	80
,, Net profit ...	21,900		
	66,500		66,500

Solution.

To complete the assessment of the above Profit and Loss Account, details are necessary for interest on G.P. Notes Rs. 10,500.

The following explanations are obtained:—

On mercantile basis the accounts having been prepared, the actual amount of interest received during the year will be obtained as follows:—

	Rs. 10,500
Less interest accrued up to P. & L. date but not receivable	Rs. 4,300
	Rs. 6,200
Add interest accrued up to P. & L. date but not receivable last year	Rs. 2,800
	Rs. 9,000

Profit and Loss Adjustment Account.

			Rs.
To Interest on G.P. Notes	10,500	By Net Profit ...	21,900
,, Dividend on shares	8,300		
,, Adjusted Profit ..	3,100		
	21,900		21,900

Business Profit as adjusted above ...	Rs.	3,100	0	0
Add Interest on G.P. Notes as per details Rs. 9,000 (net)	Rs	10,666	11	0
Add Dividend on shares Rs. 8,300 (net)	Rs	9,837	0	0
Total Income	Rs	23,603	11	0

The average rate of tax is 20·53 pies

Income-tax at 20·53 pies is Rs 2,524-1-0

Tax already paid

Rs. 1,666-11-0

Rs. 1,537-0-0

Rs 3,203-11-0

Rs 679-11-0 Refundable.

Note :—

(1) Interest on G.P Notes Rs. 10,500 is written back and Rs. 9,000 as obtained from Assessee's own particulars grossed up into Rs. 10,666-11-0 will be included in the total income.

(2) Dividend on shares grossed up into Rs. 9,837.

(3) In a banking concern Loss on sale of securities will be allowed and the profit on sale of G.P. Notes will be taxed.

Illustration 63. **Revenue Account of Ideal Printing House Ltd. for ...**

Stock on 1.4. 38		2,690 0 0	Books	10,000 0 0	
Purchases			Journals	4,000 0 0	
Paper	690 0 0		Printing .. .	5,000 0 0	19,000 0 0
Ink and Glue	90 0 0		Misc Receipts		1,000 0 0
Photo Goods	140 0 0		Dividends		700 0 0
Type Expenses	180 0 0		House Rent		2,000 0 0
Sundry Purchases	900 0 0	2,000 0 0	Closing Stock		5,000 0 0
Factory Expenses					
Factory Labour	440 0 0				
" Staff	120 0 0				
" Misc Expenses	700 0 0				
" Power	200 0 0				
" Repairs	50 0 0				
Out Printing and Binding	110 0 0	1,620 0 0			
Publication Expenses					
Publication Staff Salaries	500 0 0				
" Expenses	300 0 0				
Royalty	510 0 0				
Copyright	400 0 0				
Pub Contingencies	200 0 0				
" Stamp	100 0 0	2,010 0 0			
Overhead and General Trading Expenses .		1,000 0 0			
Depreciation .		800 0 0			
Profit & Loss account (adjustments)		100 0 0			
Balance Profit for the year .		27,480 0 0			
		27,700 0 0			27,700 0 0

Solution.

An adjustment account will be made in the usual manner. The only points requiring particular attention are (1) Copyright, (2) Type expenses

Copyright —The Income-tax Department may contend that it is of capital nature being in a way the capitalised value of royalties and therefore not an allowable deduction; but in fact copyright debit is a legitimate expense as it really takes the place of royalty in the publishers' accounts The publishers take a risk by purchasing outright in the form of copyright instead of making periodical payments of royalty Hence the expense is an allowable debit Besides, it is very often an expenditure incurred in acquiring the copyright by engaging literary assistants and paying for their services as employees The I T Department has accepted the claim

Type Expenses —In Press accounts the types are a material essential for production It should not be confused with plant or machinery which produces the printed matter It is in fact an essential consumable and replaceable material; hence it is allowed

Sec. 12, (1) The tax shall be payable by an assessee under the head "Income from other sources" in respect of income, profits and gains of every kind which may be included in his total income (if not included under any of the preceding heads).

(2) Such income, profits and gains shall be computed after making allowance for any expenditure (not being in the nature of capital expenditure) incurred solely for the purpose of making or earning such income, profits or gains, provided that no allowance shall be made on account of—

(a) any personal expenses of the assessee, or

(b) any interest chargeable under this Act which is payable without British India, not being interest on a loan issued for public subscription before the 1st day of April, 1938, or not being interest on which tax has been paid or from which tax has been deducted under section 18, or

(c) any payment which is chargeable under the head 'Salaries', if it is payable without British India and

tax has not been paid thereon nor deducted therefrom under section 18.

(3) Where an assessee lets on hire machinery, plant or furniture belonging to him, he shall be entitled to allowances in accordance with the provisions of clauses (iv), (v), (vi) and (vii) of sub-section (2) of section 10.

NOTE.--(I) Tax shall be paid by an assessee under the head " other sources " in respect of profits of every kind which does not come within the scope of the other heads of income, *e.g.*,

(1) Interest on bank deposit.

(2) Rent from sub letting.

(3) Examination fees from colleges and universities.

(4) Income from royalties

(5) Dividend of a company.

(6) Income of a Zamindar which does not come under agricultural income.

(7) Income from Debentures issued by association, firms, clubs, etc.

(8) Income from Busti lands.

(9) Annuity granted under a will.

(10) Yield from Treasury bills

(II) Expenses solely incurred for earning this income shall be deductible from the income. Personal expenses are not deductible, neither expenses of capital nature. Depreciation is allowed.

Zamindari income (except what is covered by agricultural income) will be taxed under this section but deductions like land revenue payable (though administrative difficulties will arise as to exactly what amount is paid by way of land revenue with respect to that particular subject), collection charges and other expenditure incurred solely for the purpose of earning that income should be allowed in computing the taxable income.

In Raja Jyotiprasad Sinha's case, 1921, 1, I.T.C. 103, it was decided that the owner of a coal-mine who receives royalty on coal is not a person earning profits from business but making an income from "other sources." Hence, road cess and public works cess are not allowable deduction from rents and royalties.

Cost of probate of Sradh and funeral expenses are not allowed as deduction from the taxable income of Executors even though the Will may direct expressly to meet such costs from the income of the Estate (In re: P. C. Mullick and another, 1938, I T.R. 206)

In Gooptu Estates Ltd. vs. C.I.T., Bengal, 34 C.W.N. 327.

The Company took lease of certain house properties belonging to Babu Ram Chandra Gooptu, deceased, and received rents from the sub-tenants The house at No 100, Clive Street, was one of these properties. These premises were leased to the Tata Industrial Bank, Ltd, for 50 years from the 1st August, 1920. It was agreed upon between the Company and the Bank that if the conditions of the lease were breached, the lease would at once expire In the year 1923, the Tata Bank went into voluntary liquidation to effect an amalgamation with the Central Bank of India Ltd This was considered by the company as a breach of the conditions of the lease Finally, they compromised their claim by accepting a lac of rupees, and made over the premises to the Central Bank of India Ltd at an increased rent for the unexpired portion of the lease. This lac of rupees was received on the 21st December, 1923, i.e., in the year 1923-24, and was admittedly shown under the head suspense account in the Balance-Sheet for 1923

Finally, the Company had filed a petition under sections 33, 66(2) asking for review of the Assistant Commissioner's order on appeal or for reference to the High Court of the following questions of Law:—

(1) Whether the sum of Rs 1,00,000, having been received in consideration of the waiver of their rights in connection with a breach by the lessee of a vital condition of the lease, is in the circumstances a casual gain or a non-recurring income within the

meaning of section 4, sub-section 3, clause 7, of the Income-tax Act.

(2) Whether the said sum of Rs. 1,00,000 was a salami, and whether even assuming that it was a salami, it is an assessable income within the meaning of the Income-tax Act, or is a capital and casual non-recurring receipt as held in the case, Shiva Prosad Singh *vs.* The Crown.

(3) Whether the income derived, accrued and received in the year 1923 can in the circumstances, *viz.*, the transfer of the amount from one account to another to suit the convenience of accountancy, be treated as assessable income in the year 1927-28.

Held, that the sum in question was realisation of part of the enhanced value of the assessee's assets consequent on the forfeiture of the lease and hence not assessable.

In Manindra Chandra Nandi *vs.* Secretary of State (1907), 34 Cal., 257, Justice Mukerjee in connection with the question of royalty observed :—

"The House of Lords affirmed the decision of the Court of Appeal, Stoble *vs.* Secretary of State for India, that, as capital could not be taxed as income, income-tax was not payable upon that part of the annuity which essentially represented capital. In this very case Lord Halsbury L. C. pointed out that, where we are dealing with Income-tax upon a rent derived from coal, we are in truth taxing that which is capital in this sense, that it is a purchase of the coal and not a mere rent. The Lord Chancellor further observed that the income-tax is not and cannot be, from the nature of things, cast upon absolutely logical lines, and to justify the exaction of the tax, the things taxed must have been specifically made the subject of taxation. We are, therefore, brought back to the question whether 'royalty' is income within the meaning of the Income-tax Act. The term "income" is not defined in the Act, and the explanation given in section 3, clause (5) that it means income and profits accruing and arising or received in British India, does not throw much light upon the question. The word "income" however is, to use the language of Sir George Jessel *In re. Huggins*, as large a word as can be used to denote a person's receipts, and it seems to me that it is wide enough to include a royalty received from a mine. The nature of a royalty was examined at some length by Lord Denman C. J.

in Reg vs. Westbrook and Reg vs. Everist; it appears to have been contended in that case that it is altogether wrong in principle to consider the royalty as rent, because it is a sum paid not for the renewing produce of the land, but for severed portions of the land itself The learned Chief Justice answered this argument by observing that the occupation of a mine is only valuable by removal of portions of the soil, and whether the occupation is paid for in money or in kind, is fixed beforehand by contract or measured afterwards by the actual produce, it is equally in substance a rent, inasmuch as it is the compensation, which the occupier pays the landlord for that species of occupation, which the contract between them allows. As pointed out by Lord Denman, this would not admit of an argument in an agricultural lease, where a tenant was to pay a certain portion of the produce, which would be admitted to be in all respects a rent service with every incident to such a rent The same view was adopted in substance by Sir Charles Abbott, C. J. in King vs Alfwood and by Lord Blackburn in Coltness Iron Company vs Black Lord Blackburn referred to the observations of Lord Cairns in Gowan vs. Christie that a mineral lease, when properly considered, is in reality a sale out-and-out of a portion of the land, but remarked that this did not justify the inference, that no income-tax should be imposed on the rent reserved on a mineral lease The distinction between a price paid down in one sum for the out-and-out purchase of the minerals forming part of the land, and the rent and royalty which constitute, in reality, a payment by instalments of the price of those minerals, is intelligible, though it may not be quite logical, thus affording an illustration of Lord Halsbury's observation in Quinn vs Leathem that law is not necessarily a logical Code and is not always logical at all The view I take receives some support from the definition of the word "income" as given in the Oxford Dictionary, Vol. V, page 162. Income is defined to be "that which comes in as the periodical produce of one's work, business, lands, or investments considered in reference to its amount and commonly expressed in terms of money, annual or periodical receipts accruing to a person or corporation". . . I must hold consequently that the royalty received by the plaintiff is 'income' within the meaning of Act, II of 1886.

Letting out machinery is included in business and it has been specifically provided by the new Act that depreciation is allowed.

In C.I.T., Madras *vs.* Mangalagiri Sri Umamaheswara Rice Factory, 1926, 2 I.T.C. 251, the assessee joint stock company instead of working the mill themselves leased out the mill for fixed annual rent. The articles of association having given the power of letting out the machinery it was held that depreciation would be deductible.

The case of Sadhu Charan Roy Choudhary who let out a jute press on lease and agreed to carry out repairs to the machinery and buildings was a case of carrying on business and deduction of depreciation was allowed.

NOTE – By the new Amendment Act Section 12(3) this is specifically allowed and this sub-section came into operation on 1. 4. 39 whereas sub-section (*vi*) and (*vii*) of section 10(2) which two have been referred to in section 12(3) have come into operation on 1. 4. 40.

12A. Where a managing agent of a company is liable under an agreement made for adequate consideration to share managing agency commission with a third party or parties, the said agent and the said party or parties shall file a declaration showing the proportion in which such commission is shared between them, and on proof to the satisfaction of the Income-tax Officer of the facts contained in such declaration such agent and each such party shall be chargeable only on the share to which such agent or party is entitled under the agreement.

Where a managing agent has got to pay to another party under an agreement a portion of his commission, each person including the third party will be assessed in respect of his net amount to which he is entitled, instead of the third party's due being added to the managing agents' own commission for assessment.

The diversion of the third party's due is recognised by the Act on the same lines as in the case of Raja Bejoy Singh Dudhuria.

This section has been designed particularly to meet the hardship experienced in the case of Tata Hydro-Electric Agencies *vs.* C.I.T., Bombay, 1937, I.T.R. 202.

Sec. 13. Income, profits and gains shall be computed, for the purposes of section 10, and 12, in accordance with the method of accounting regularly employed by the assessee:

Provided that, if no method of accounting has been regularly employed, or if the method employed is such that, in the opinion of the Income-tax Officer, the income, profits and gains cannot properly be deduced therefrom, then the computation shall be made upon such basis and in such manner as the Income-tax Officer may determine.

Income, profits and gains shall be computed in accordance with the method of accounting regularly employed by the assessee

If no method is regularly employed or if the method does not enable the Income tax Officer to arrive at a correct estimate of the profits then the Income tax Officer may determine the basis on which computation should be made Assessee cannot change his method year to year but he should be allowed to adopt a new regular method

Under this section assessments may be made on an assumed flat rate of profits on the turnover The basis of flat rate will be determined by the Income tax Officer with reference to the convention and practice in similar trades

Every assessee should maintain accounts with a view to show, at the end of the year, the actual income made by him, so that on production of his yearly revenue account, the I.T.O. can base his assessment on it. If the assessee fails to keep accounts or fails to keep accounts in a way which will give the correct profit at the end of the year he can have no complaints against the I.T.O. for the latter's making an estimate. The I.T.O. will make his estimate on the data available with utmost judiciousness.

The accounts presented by the assessee should *prima facie* be taken as correct. When fraud is detected or doubts arise in the mind of the I.T.O., he can choose his own method of computation. It must be remembered by the I.T.O. that he is in the rôle of a judicial officer and complicated accounts is no ground for rejection of accounts. Strictly regular accounts are not always possible in the case of ordinary traders. (Duni Chand Dhani Ram *vs* C.I.T., Punjab, 1926, 2 I.T.C. 188.)

In C.I.T., Madras *vs* Subramaniam Chettiar, 1927, 2 I.T.C. 365, it was pointed out that an assessee may adopt either Mercantile system or cash system but he cannot use Mercantile system for the purpose of keeping books of accounts and cash system for the purpose of income-tax assessment.

In Sarupchand *vs* C.I.T., Bombay, 1936, I.T.R., 420, it was decided that the Commissioner's contention that it is not open to a person to change a method which he has regularly employed for some years was not correct and that there is nothing in section 13 of the Act to prevent an assessee from changing his method.

In Feroz Shah *vs* C.I.T., Punjab, 1933, I.T.R., 219, the Privy Council observed:

"Dissatisfied with the assessment upon him, the appellant under Section 30 of the Act, appealed to the Assistant Commissioner of Income-tax, Rawalpindi. His grounds of appeal, in effect were (1) that according to his method of book keeping, a transaction of sale was not entered in his books until the day when the hundi in respect of it was received from his purchaser, and that the hundis for the Rs. 90,618 were received in, that is, were not received before April, 1927; and (2) that the officer was not correct in working out the profits at a flat rate of so much as 32½ per cent."

The present appeal is from that order of dismissal of the 28th November, 1929, and their Lordships are satisfied that it is an appeal without foundation. It was mainly rested on the contention that the assertion of the Income-tax Officer as to the appellant's accounts being kept on the mercantile system could not in point of law be supported. A profit and loss account and

a valuation of stock were, it was contended, essential to a mercantile system of accounting, and no such account had been prepared by the appellant, while no valuation of stock had, it was conceded, been made. Their Lordships do not propose to discuss this question, which hardly seems to them to be one of law. Too much emphasis has, they think, throughout the case been attached to the use by the Income-tax Officer and the Assistant Commissioner of the term "mercantile system." The finding of both in its essential substance, was that the appellant's system of accounting, by whatever name called, required the inclusion in his accounts of 1926-27 of the Rs 90,618 referred to, and the only question open to judicial determination is whether there was any evidence before these officers upon which they might so find".

"In these circumstances it is, in their Lordships' judgment, impossible to say that there was no evidence before the Income-tax Officer and the Assistant Commissioner upon which they might find, as they did, that this item of Rs 90,618 was excluded from the appellant's accounts of 1926-27 out of the ordinary course and for reasons not to be justified."

In C.I.T., Bombay vs. Sarangpur Cotton Manufacturing Co. Ltd., 1938, I.T.R., 36 (P. C.)

The Company submitted under Sec. 22 (1).

(*a*) a copy of the audited Balance sheet and P & L A c,

(*b*) a return of total income of the Company,

(*c*) a covering letter which explained the adjustments in figures in P & L A c to arrive at the figure of income in the return

The I T.O. completely disregarded the covering letter which worked out the adjustments necessitated by alleged undervaluations of opening and closing stocks The adjusted figure was smaller and the I T.O. took the larger figure by ignoring the covering letter. On appeal, the High Court was of opinion that the covering letter formed part of the method of accounting employed by the assessee within the meaning of Sec. 13 of the Act and that the

I.T.O. was not entitled to ignore one part and accept the other.

The Privy Council observed :—

"**Lastly, if there were any doubt, the appellant himself has put the matter beyond the possibility of doubt, by the statement in his order of —— ,that the object of the under-valuation was the creation of a 'secret' reserve, which involves the retention of profits so as not to be included in the profits shown to the shareholders by the Profit and Loss Account and Balance-sheet but which constitute part of the taxable profits. This negatives any suggestion that these accounts show the true profit for income-tax purposes.**"

Thus the I.T.O. was shown by the appellants themselves that due to the necessity of a secret reserve, in the P & L A/c as printed and presented to the shareholders, some adjustments would be required for computing the taxable profit. In spite of this clear explanation, if these adjustments are not taken notice of by the I.T.O., in his overanxiety to tax a larger amount then, the Privy Council's observation "*that the view that the Income Tax officer is prima facie entitled to accept the profits shown by the accounts, where there is a method of accounting regularly employed by the assessee is not a correct view. It is the duty of the I.T.O. where there is such a method of accounting to consider whether the incomes, profits and gains can be properly deduced therefrom*" cannot be construed to mean that the accounts are undependable for the I.T.O. to base his assessment upon and on this ground it cannot be construed that the I.T.O. is not entitled to accept profits shown by the accounts. What this observation means is that the I.T.O. has put too narrow a meaning to the word "accounts" by rejecting adjustments on a separate statement and in this narrow view the I.T.O. cannot accept the printed accounts; he should consider the adjustments as well. In fact, in view of assessee's detailed information and explanations, the

I.T.O. does always make necessary adjustments and for this reason, neither the accounts can ever be considered undependable nor does the I.T.O. consider himself any the less entitled to accept the profits shown by the accounts as his basis. The observation of the Privy Council in this particular case is perfectly correct as the interpretation of the word 'accounts' is so narrow. The Privy Council has never meant any larger powers to the I.T.O. and it cannot mean that the I.T.O. is the sole judge in this matter — on the contrary, the Privy Council points out the lapses of the I.T.O. that he has wrongly left out the accounting implications of the covering letter. In the observation, one should note the words "where there is such a method of accounting". It follows that where there is no such method or this procedure the I.T.O. is *prima facie* entitled to accept the profits as shown by the accounts but the word "accounts" must be taken to include adjustments also and not merely the printed P & L a/c which is prepared mainly from the business point of view.

The I.T.O., is not justified in rejecting the books of accounts merely because they are complicated or without calling upon the assessee under section 23(2) to appear before the I.T.O. (Dunichand Dhani Ram *vs.* C.I.T., Punjab, 1926, 2 I.T.C. 188.).

Section 13 does not confer arbitrary powers on the I.T.O. to act without evidence. The I.T.O., has power, under the circumstances, provided in the proviso to employ his own method but he must employ some basis and that basis should be stated in the assessment. In re: Radhey Lal Balmakund & others 1931, 4 I.T.C. 454, Dunichand Dhani Ram *vs.* C.I.T. Punjab, 2 I.T.C., 188.)

In Asgar Ali and Mohammad Ali, *vs*, C.I.T., U.P. 6, I.T.C., 27, it was decided that the flat rate which may be assumed does not raise any question of law.

In Dhakeshwar Prasad Narain Singh *vs.* C.I.T., Bihar, 1938, I.T.R. 71, it was observed as follows:—

"The assessee carried on a money-lending business. His book's of account consisted of personal accounts of his debtors in which

the interest which accrued from year to year was calculated and entered and the amounts actually realised as interest were also entered. But neither the accrued interest nor the realised interest were totalled in an interest account and no profit and loss was computed. There was also a cash book in which the actual realisations were shown but there was no interest ledger. For the purposes of his return for income-tax in previous years he totalled the amount of interest which had accrued in the particular year in question. For the year 1931-32 he submitted a statement showing the interest which he had actually received and contended that he could not be assessed upon accrued but unrealised interest but only upon interest realised by him. The question 'whether in the circumstance of the case the assessee was liable to be taxed on his income from money-lending on the mixed cash and accrued basis which had been followed in his assessment of previous years was referred to the High Court·

Held, Per Courtney-Terrell, C.J.—(i) The assessee had not regularly employed any method of accounting within the meaning of Section 13, and his request did not involve any change in the method of accounting but only a change of the meth d of assessment which should be employed· (ii) that though it is open to an Income-tax Officer to assess either upon a cash basis or upon a mercantile basis, accrued interest can only be taken into account if a profit and loss account is drawn up and the accrued but unpaid interest is brought in as a valued asset; it was not open to the Income-tax Officer to take the accrued interest into the assessment on any other basis and the method of assessment which had been followed by the income-tax authorities was in any case erroneous."

Thus where a method of accounting, though perhaps not a normal one, has been regularly employed by the assessee himself, from which the profits of the business can properly be and has been deduced, proviso to section 13 does not apply.

In Bansilal Abirchand, Nagpur, 1928, 3 I.T.C. 57, the assessee who was dealing in stock-exchange securities adopted a method in accounts which meant spreading the profit or losses over a period of years. The Assistant Commissioner held that the account should be closed every year and profits or losses to be found every year.

The Commissioner held that the loss in this case could not be regarded as loss of the previous year but of various previous years and therefore this was not permissible. The Judicial Commissioner held:

That there was no reason why the assessee should not be allowed to claim the losses in question, under the system of account adopted by him, when whether the book system of account adopted by the assessee was desirable one or not, no profits could eventually escape taxation thereunder, although possibly the income-tax authorities might in any particular case have to wait a longer time before receiving profits.

In C. I. T., Bombay *vs.* The Ahmedabad New Cotton Mills, 1928, 3, I. T. C. 91, the assessee submitted his return in which he undervalued both his opening and closing stock. A revaluation of the closing stock was ordered by the I. T. O. but he would not allow a similar revaluation of the opening stock as was naturally insisted upon by the assessee. The High Court decided that there should be revaluation of both the items.

In Sahu Jagmandar Das *vs.* C. I.T., U. P., 1935, I. T.R. 140, interest was decreed and under Mercantile system interest was shown credited in the accounts but no part realised. It was decided that it was not taxable.

I. T. M. instructions are as follows:

Method of accounting for assessing income, profits and gains under sections 10, 11 and 12. (*See section 13.*)—(i) Owing to a High Court ruling, referred to in paragraph 13, regarding the definition of the word "income" the provisions in the present Act have been so worded as to make it clear that as regards income, profits or gains from business, professional earnings or the other sources mentioned in section 12, no uniform method of accounting is prescribed for all tax-payers, and that every tax-payer may, so far as is possible, adopt such form and system of accounting as is best suited for his purposes. The only restrictions are that the method adopted must be one that clearly reflects the income of the assessee in respect of the fixed period of "the previous year" and that it is the one regularly employed by him for the purposes

of his business. *If the tax-payer does not regularly employ a method of accounting which clearly reflects his income for the "previous year," the computation will be made in such manner as in the opinion of the Income-tax Officer does clearly reflect it.*

(*ii*) There are two main systems of keeping accounts. There is, firstly, the cash basis system, where a record is kept of actual receipts and actual payments, entries being made only when money is actually collected or disbursed. It is probably unusual for a trader to calculate his profits on this system. If he does so, it must be remembered that the difference between the value of his opening and closing stocks must be taken into account in computing the year's profit, in order to secure a proper and even distribution of his profits over a series of years. There is, secondly, the mercantile accountancy system under which a profit and loss account is maintained and a comparison is made of the value of the stock in hand at the beginning and at the end of each year. Under this latter system entries are made in the accounts on the date not of receipt of money or expenditure of money, but on the date of transactions irrespective of the date of payment. When goods are sold, for example, an entry is made at once on the receipt side of the account, although no cash may be received at the time in payment of such goods; and an entry is similarly made on the debt side when a liability is incurred although payment on account of such liability may not be made at the time. It will be the method of accounting adopted for or by the tax-payer, therefore, that will determine the period within which any item of gross revenue or any deduction therefrom is to be accounted for, and which will determine whether particular allowances are or are not permissible.

Method of accounting "regularly employed" (Section 13)—(*i*) The method of accounting regularly employed by an assessee for the purposes of his business should, so far as possible, be the method adopted for working out his profits for income-tax purposes; but the Income-tax Officer has to decide whether that method of accounting is the one regularly employed for the purposes of the assessee's business and whether it is such as to reflect clearly the taxable profits for the "previous year". In most cases this should cause no difficulty. Doubtful cases should be referred to higher authorities. As an example of the principles to be followed in settling doubtful cases, two instances of such cases are given. It is the practice amongst certain merchants to prepare their accounts on the basis of the mercantile accountancy system

in respect of transactions between themselves and members of their own community, but on the basis of cash payments in the case of transactions between themselves and their customers. Provided that the same system is continuously employed, there appears to be no reason why this particular practice should not be considered to be a "method of accounting regularly employed". Again there are cases where the various branches of a business are only closed once in three or five years and where the accounts of the branches are not annually incorporated in the headquarters business's accounts. In such a case it might be possible to assess either on the average annual profits of the branches as disclosed by the accounts last filed or on the actual profits brought to account owing to particular branches closing in particular years.

(ii) The cases in which an assessee desires to change his accounting system should be rare and where such a request is made, the Income-tax Officer in considering it should, as in the similar case of a demand for a change in the "previous year" (paragraph 6), if he is prepared to allow the change, take steps to secure that no profits escape taxation on account of the change. While section 13 leaves it to the discretion of the Income-tax Officer to decide whether a particular system of accounting should be accepted or whether a change in the system of accounting should be allowed, the discretion of the Income-tax Officer in this matter can be questioned in the course of an appeal against an assessment under section 30, i.e., it may be made one of the grounds of appeal in contesting the assessment of the profits. (I. I. M.)

British Cotton Growers' Association (Punjab), Ltd., *vs.* C.I.T., Punjab, 1937, I.T.R. 279.

"An assessee is no doubt at liberty to adopt any system of account that he likes but as indicated in paragraph (c) of the Notes and Instructions regarding the Income-tax law and rules, it must be one that clearly reflects his income in respect of the fixed period of the 'previous year' and that it is the one regularly adopted by him for the purposes of his business."

Receipts kept in suspense:

As regards the question whether sums received in back years, which are kept in suspense till the date when the settlement of the particular loan is made, according to the method of accounting regularly adopted by assessee, can be treated as the income of the

year of settlement, which is the 'previous year', within the meaning of the above dictum of the learned Judge, there is support in its favour both in (1) practice in the Income-tax department as well as in (2) authority.

Regarding (1), Contractors whose work generally extends beyond the period of the accounting year, have their income of the 'previous year' computed by assessee and also by the Income-tax department generally in one or other of the following methods:

(i) The income may be computed by taking some reasonable percentage of the actual receipt in the accounting year. This is what is known as cash system; or

(ii) If the account of each job is kept separate from others, no account is taken of receipts in pending contracts, but the total income arising out of that job is taken as the income of the year in which the work is completed, and accounts are finally taken and settled, though part of this income was actually received earlier than the year of settlement. This is neither mercantile nor cash system

Regarding (2), an authority in support is the case of Jugal Kishore Mukat Lal *vs.* C.I.T. U.P., 1932, 6 I.T.C. 184. There, according to the method of accounting regularly employed by the assessee, profits from forward contract business, received by the Bombay agent of assessee were credited in head office accounts at Khurja on receipt of intimation. It so happened that income received by the agent at Bombay in 1928-29 was intimated to Head Office in 1929-30 and was shown by assessee as the income of 1929-30 in the assessment for 1930-31 It was held that under section 13, the income actually received in 1928-29 but credited in head office books in 1929-30 should be deemed to be the income of 1929-30.

The above case of Jugal Kishore is an authority for the proposition that if sums received in back years, are credited in the account as income in a subsequent year, according to the method of accounting regularly followed by an assessee, it should be treated for assessment under section 13 as income of the subsequent year; it is obvious that the principle of the ruling relates to the methods of accountancy and covers both the back years receipts as well as those received in the accounting year.

In Raja Raghunandan Prosad's case, cash basis was followed. The assessee did not regard nor did he treat the interest on the old mortgage as having been liquidated by the execution of the new mortgage in lieu of the old one plus accrued interest. When a debt is paid off by payment of cash, the debtor's liability ceases but when it is paid by a fresh pronote the liability remains and as there is no realisation either of capital or of interest the question of taxation does not arise (Raja Raghunandan Prosad *vs.* C.I.T., Bihar, 1933, I.T.R 113; A.I.R. 1933, P.C. 101). When the principal sum and interest are both outstanding and the mortgaged property is purchased, the excess of the purchase money over the principal sum should be taken as interest payment

Suspense account and purchase of mortgaged property: In money lending business it is a common practice to set apart the income to a suspense account. In the case of C I T, Bihar, *vs.* Maharaja Darbhanga Sir Kameswar Singh (1933, I T R, 94, P C ; 60 I A 146) cash basis was followed which was disclosed to the tax authorities and calculation was based on actual receipts in the year of computation.

The Judicial committee laid down the following principles:

(*i*) Where interest is outstanding on a principal sum due and the creditor receives an open payment from the debtor without any apportionment of the payment as between capital and interest, by either debtor or creditor, the presumption is that the payment is attributable in the first instance towards the outstanding interest and the revenue authorities would be justified in treating the amounts paid as payments of interest in the first instance; but (*ii*) where there is not an open payment but an arrangement affecting the whole indebtedness, for example, where

an assessee takes over from his debtor in leiu of a loan, certain items of property, the basis of the presumption that it is to the creditor's advantage to attribute payments to the interest in the first place, leaving the interest bearing capital outstanding, is gone and the assessee is entitled to appropriate the amounts to the principal in the first place and the balance alone towards interest. (C.I. T., Bihar *vs.* Kameswar Singh 1933, I.T.R., 94, P.C.)

The assessee regarded the fresh pronote as settlement of the claim to the interest on the old loan and his books also recorded this receipt as receipt of income and hence the interest is taxable as income (V.S.U.R. Firm *vs.* C.I.T., Burma, 1935, I.T.R. 158.)

Where the method of accounting is one regularly employed by the petitioner assessee, the proviso to section 13 does not come into operation. (Feroze Shah *vs.* C.I.T., Punjab, 1930, 4, I.T.C. 315.)

In a case where the Income tax Officer found that some sales which were made by the assessee had not been brought to account and the assessee gave a treatment of these sales not according to any accepted system regularly employed, the judicial committee held that the finding was not based on no evidence (Feroz Shah *vs.* C.I.T., Punjab, 1933, P.C. 198; 1933, I.T.R. 219.)

In Shiv Prosad Gupta *vs.* C.I.T. U. P., 1929, 3 I.T.C. 406.

Justice Mukerjee said:- "That system is this. In any particular year the amounts that have become recoverable are shown as the income actually received and the liabilities incurred are shown as amounts actually disbursed. Under this system, the merchant, in order to ascertain his income which is really a 'book income' deducts from the profits accrued according to his books, the losses that he has suffered, also according to his books. The balance is a net book income. Under section 13 of the Income-tax Act this net 'book income' may be accepted by the Income-tax Officer as a fair estimate of the merchant's income. The reason

will be twofold. The merchant himself uses this method of ascertaining his own income and secondly the method is not an unfair one."

True position explained.

Section 13 has two very important aspects. In one aspect, the imporant case is Sarangpur Cotton Manufacturing Co. where it was emphasised that the accounts have to be carefully gone into by I.T O to see and discover if defects exist and profits can be properly deduced

In the other aspect, the leading cases are those of Raja Raghunandan Prasad and Maharaja of Darbhanga Sir Kameshwar Singh where it has been emphasised that the assessability of interest depends on the system followed and treatment actually given in the books of account

After going through the cases quoted above, one feels helpless in the midst of conflicting decisions in ascertaining as to the taxability of interest credited in the P and L account under mercantile system In the mercantile system, interest credited is taxed but some decisions clearly state that in certain cases, it has to be ascertained whether interest has actually been received or not

The explanation of this peculiar position is the fact that besides the two main systems of accounting, *viz.*, cash and mercantile, there may be and actually there are methods which are neither one nor the other or which are combinations of the two Such combined systems are prevalent in Madras amongst the Chettiars and in Burma and also to some degree in Bengal and Bihar mainly in money-lending business

Income-tax Manual and other literature on the subject emphasise the two systems cash and mercantile but be it noted that the section 13 never makes any mention of them beyond stating "that it must be regularly employed." If it is regularly employed, the main section is

satisfied; the proviso cannot be brought into operation, unless the position of the assessee in regard to accounts is unsound or the assessee is not acquainted with the correct procedure of approach to defend his own position. The assessee has to remember *that having made the Return based on an accounting system regularly employed, he must prove that the income returned is the correct income so that the Income-tax Department may not be able to prove that there is any mistake, flaw, or error in the application of the very method employed.*

It is therefore necessary at this stage to emphasise upon the assessee that he has, having made the Return, two extremely important things to do

(1) Satisfy Sec. 22(4)
(2) Satisfy Sec. 23(2)

In other words, the assessee must take it to be his duty to answer any specific thing that may be asked [22(4)] and he must prove by all means in his power that his Return is correct [23(2)].

It is not for the I.T.O. to say why a particular thing was not done and why not in a particular way, for, the business man is to do his business and keep his accounts as it suits his business. In this connection a very pointed observation was made by Justice Niamatullah in Gopi Nath Naik's case: "It cannot be said that the onus lies on the assessee not only to substantiate his Return but also to disprove every allegation or assertion which the Income-tax Officer may choose to make." *The I.T.O.'s duty is* to *show where any omission or commission has been made in the method itself and where any mistake has crept in; or to put his whole objective briefly, "I.T.O.'s duty is to prove that by the adoption of the assessee's method, an income escapes from assessment."* Where the assessee fails to prove the correctness of the books of accounts and to justify his statements and assertions, the proviso is in-

voked by the I.T.O., and once the proviso is invoked, I.T.O.'s own computation inevitably follows.

The true position of the accounting systems in money-lending business can hardly be summarised as there are various grades or shades of combination of the two systems. But what is prevalent in Bengal and elsewhere also is :—

(1) In respect of money advanced on a Hatchita or Khatapeta —mercantile system,

(2) In respect of money advanced on pledge of ornaments, hand notes and mortgages - cash system or the following system

When the debtor makes payments on account, they are credited in the accounts against the loans on the respective dates Interest which accrued on these loans until they are completely paid off, is kept in suspense account

When the loan is finally paid off, total interest receivable on the loan from the execution to its extinction, will be credited to interest account Thus the total interest on the loan is shown not spread over the whole period but as income of the year of settlement

If the accounts are consistently kept in the above system and no flaw, mistake, or omission can be discovered by the I.T O. and if the assessee can prove that no income is concealed by the method, Income-tax Officer has no reasonable grounds to reject accounts and the system adopted shall be the basis for assessment The I.T O cannot reject the accounts merely on the ground that the system adopted is not a very good system or is not a commonly accepted system The section gives a wide latitude to the assessee and if a narrow interpretation is given, it is done on a misunderstanding of accounting. So long as no mistake or concealment is discovered the system, if it is a system regularly employed, shall be accepted.

Though the cases cited show that the I.T.O. has got statutory right under certain conditions to accept or to reject the books of accounts, still, the tax authorities should be very careful in dealing with complicated accounts as are adopted with modifications to suit business requirements. While there are decided cases of assessee's carrying on mony-lending business, share speculation business, etc., the profit or loss of which took a longer time than a year for its final settlement or computation, there is another class of cases, *viz.*, accounts of building contractors, engineering firms and allied undertakings which require the most careful consideration of the experts.

In such case of contractors, *etc.*, the questions like the valuation of

(*a*) works done but not billed for,

(*b*) works certified by architects,

(*c*) works done but not yet certified, etc.,

are subtle and proper questions but it must be admitted that in most cases in India, such questions are purely of theoretical value Whether this is of theoretical value or of practical importance will depend upon the system that the assessee may consistently follow, *viz.*,

either (1) taking estimated profits on incomplete works,

or (2) not taking any such estimated profits

The Mercantile system does not necessarily mean that profits on uncompleted contracts must be taken. It is a text book maxim involving arbitrary and hypothetical calculations in most cases and without any reference to actual experience. The business men may adopt this system or any other according to their own requirements and resources. If one system is followed, true profits will be reflected in the accounts and the auditors or the income-

tax authorities have no right or justification to press for the adoption of their own or known systems. They can only advise but he alone can press who pays the piper.

Besides, from the income-tax point of view, the department, may, with some justification, refuse to agree to the assessee's taking the profits in annual instalments (resulting from annual valuation of incomplete works) as this has the effect of spreading out the profits of a contract over a number of years and thus avoiding super tax.

Such cases which demand careful consideration and accountancy knowledge are those where such firms carry on construction work but have neither use nor means of valuing the works in hand at the end of the year. Some of these firms may very legitimately continue a method of accounting which does not involve them in the valuation of the closing works. Their method is to carry on the construction work and thus debits will pile up until the contract price is finally credited in the A/c, when profit or loss can be accurately found out any intermediate valuation is likely to be very unreliable and will be a costly method not within the easy reach of small or middle class contractors The authorities of accountancy profession have full approval for such method and as a matter of fact, this is considered to be sound if only the contractors and business men can afford to wait for taking into account the profits at the long end Companies which have to distribute dividends to their shareholders cannot afford to wait but firms with sound financial position can and therefore estimates are undesirable because an estimate is either costly or undependable

Experts' opinion.

Prof. De Paula writes :—

"In practice, profit sometimes anticipated and although theoretically this is not correct, is a well known custom which in proper circumstances an auditor may pass." Again

he writes. "But where this is done very great care may be exercised in estimating such profits, and ample reserves must be made for contingencies, for it must be borne in mind that a contract may be progressing normally and present figures indicate that considerable profits will be earned, but some unforeseen contingency may arise such as strike, collapse of a part works, rise in the price of raw materials".

Messrs Spicer and Pegler write :—

"There can be no doubt that theoretically it is preferable not to take any profit until the whole contract is completed, as in many cases, although the contract may be near completion, some contingency might arise which would destroy the whole profit that was anticipated"

In J. P. Hall & Co., Ltd. *vs.* C. I. Revenue, 1921, 3 K B., 152, before the Court of Appeal Lord Sterndale observed :

The respondents contend that as they were bound to make a profit on the sub-contract for the supply of the Control gear, although payments were deferred until delivery at future dates, yet they are entitled to allocate the profits to the pre-war period during which contracts were entered into That argument is contrary to the system of book-keeping adopted by them and to ordinary commercial procedure, according to which profits are not brought into account until they are realised For the purposes of income-tax, the profits in this case would be treated as having been made at the respective times of payment . The accountant who was called, the respondent's auditor, said that that profit might well have figured in their accounts when contracts were made but he admitted that in the ordinary way, and I rather think he meant the ordinary way of keeping business accounts, at any rate the ordinary way of keeping respondent's accounts, such a profit would not be included in the accounts, until the invoices were received, that is to say the actual dates of the delivery of the goods Rowlatt J. has held that they are entitled to bring the whole of the profit upon this contract for the control gear into the year in which the two contracts were made and I suppose, on the contention stated by the respondents before the commissioners, that the profit on the transaction in question was ascertained and made on the completion of the con-

tracts. The simple answer is that the profit was neither ascertained nor made at that time . . . Many contingencies might have happened to prevent the realisation of profit which was anticipated when the contracts were made. Many complications might have occurred that might have produced a different result. I think that the respondents did right in the way that they carried these profits into their accounts; it is the ordinary commercial way of making up accounts, and in my opinion, it is the right way. It would be wrong to carry into accounts, as profits of one year, the estimated profits which would accrue in subsequent years and which might perhaps be never made at all. I think the commissioners whose decision was reversed by the learned judge, came to a proper conclusion. This appeal should be allowed and the commissioners decision restored with costs

PR. AL. M Muthukaruppan Chettiar *vs.* C I.T., Madras, 1939, I.T.R. 76, the observations are as follows :—

"Section 13 of the Indian Income Tax Act relates merely to the method of accounting and under this section though the Income-tax Officer may adopt a method of accounting which he prefers where the assessee has no regular or proper method, he cannot reject the assessee's books Nor can the books of an assessee be rejected merely because they do not relate to his foreign business also.

When claiming an allowance in respect of depreciation, the assessee must give the particulars required by proviso (*a*) to Section 10(2)(*vi*) and if he does not do so the authorities would be justified in disallowing the claim.

The assessee closed his money-lending business in Colombo on 31st May, 1930, having made a profit there of Rs 57,650. He transferred this sum to Singapore where he had been carrying on money-lending in partnership. On 8th August, 1930, this partnership was wound up and a new firm was formed in which this sum of Rs. 57,650 was shown separately as part of the capital contributed by the assessee. On 16th May, 1931, the Singapore firm advanced a loan of Rs. 48,300 to a Rangoon firm and in May, 1934, the Rangoon firm repaid this loan by accepting hundies drawn by the Singapore firm to the order of the assessee. There was evidence that the assessee had written to the Singapore firm to debit the amount in question against this particular item of

Rs. 57,650 contributed by him, and the amount was so debited. The income-tax authorities held that as the old Colombo profits had become mixed up with the funds of the Singapore firm which included the current profits of the firm, the remittance must be treated as sent from the current profits of this firm. The assessee, on the other hand, contended that what he received was a mere repayment of the old profits of Colombo which he had invested in the Singapore firm:

Held, that there was positive evidence to show that the remittance represented the profits of the Colombo firm which had become defunct in 1930 and the amount was not therefore assessable as a remittance from the current profits of the Singapore firm.

The assessee had lent moneys to various people before and in 1930, and in all cases payments had been made to account in 1930. The mortgaged properties were sold in the year 1930-31 and there were no realisation after 1930-31. The debts were written off as bad only in March, 1934. The Income-tax Officer held that they had become bad before April, 1931, and should have been written off long before April, 1931. Held, that there were no materials on which the Income-tax Officer could hold that the debts should have been written off before April, 1931, and the assessee was entitled to write them off in 1934."

In re Krishna and Co., 1939, I.T.R. 513.

"It was observed: "When assessment is levied at a flat rate the question at what rate the profits should have been calculated is essentially a question of fact.

Where a building contractor's accounts were maintained on the mercantile system of accountancy; Held, that he would be liable to be assessed on the profits shown in the accounts even though a portion of the amount spent by him in making the constructions had not been realised."

In Pioneer Sports, Ltd., vs. C.I.T., Punjab, 1933, I.T.R. 216. "It appeared from the assessees' account-books that the price charged by them from a particular customer was lower than what they charged from other customers and that though the turn over for the year of assessment of the assessee was practically the same, yet the net profits were much lower than those of previous years, and the assessees were assessed under the proviso to Section 13 of the Income Tax Act, on the ground that there was something wrong with the assessees' books. On an application by the asses-

sees the High Court held that the case involved a question of law whether under the circumstances the Income-tax Officer was justified in proceeding under the proviso to section 13 and directed the Commissioner to refer the question to the High Court."

14. (1) The tax shall not be payable by an assessee in respect of any sum which he receives as a member of a Hindu undivided family.

(2) The tax shall not be payable by an assessee—

(a) if a partner of an unregistered firm, in respect of any portion of his share in the profits and gains of the firm computed in the manner laid down in clause (b) of sub-section (1) of section 16 on which the tax has already been paid by the firm; or

(b) if a member of an association of persons other than a Hindu undivided family, a company or a firm, in respect of any portion of the amount which he is entitled to receive from the association on which the tax has already been paid by the association.

Section 14(1)

exempts inclusion of Hindu undivided family income received by an individual member.

Section 14(2)

is designed to avoid double taxation, hence tax shall not be payable by an assessee in respect of

(*a*) A partner's share of profits in an unregistered firm when the firm was directly taxed and tax paid.

(*b*) Share of a member of an association of persons which share he is entitled to receive.

Hungerford Investment Trust, Ltd., 1935, I.T.R. 65, 1936, P.C. 219, a company registered in England, held the entire ordinary share capital in the Turner Morrison Co., Ltd., registered in India. The latter company paid dividends to the former on the shares held.

The Turner Morrison Co., Ltd., was assessed on the profits barring a sum of Rs. K exempted under section

4(1) of the Act. This sum of Rs. K represented the income from its sterling investments in U. K. and therefore it could not be taxed. Hungerford Investment Trust, Ltd., received the dividend of the Turner Morrison Co., Ltd., which included income from sterling investments of Rs. K. So far as the assessment of Hungerford Trust was concerned its contention was that once the T. M. Co., Ltd., was taxed (no matter on how much) *any* amount of dividend received by the Hungerford from the T. M. Company will remain outside the scope of the tax. This decision was given by the Calcutta High Court relying entirely on the wordings of the section 14(2) (*a*) which runs as follows :—

> "The tax shall not be payable by an assessee in respect of any sum which he receives by way of dividends as a shareholder in a company where the profits or gains of the company have been assessed to income-tax."

The intention of the above section is quite clear, *viz.*, that there shall not be double taxation. The source having paid, payment shall not be made again on the same income. The assessee took advantage of the rather loose wordings and the court also had to lay stress on the wordings only and did not allow its receipts Rs. K to be taxed.

Illustration 64.

Suppose the profit and loss account of T. M. Co., Ltd., as follows :—

Receipt side	Rs.
By agricultural income	40,000
,, interest on sterling investments (not brought into British India) ...	70,000
,, tax-free securities dividends ...	20,000
,, business profits	45,000
,, taxed dividends—(gross)	25,000
	Rs. 200,000

From the above items of receipt,

Agricultural income is exempt from tax Rs. 40,000

Interest on sterling investments is exempt from tax ... ... Rs. 70,000

Dividents from tax-free securities ... Rs. 20,000

The balance Rs. 70,000 will have to bear tax. According to the decision of the Hungerford Investment Trust, Limited, as the T. M. Co. (source) has borne tax on Rs. 70,000 though this assessable amount is only a portion of Rs. 200,000, still, according to section 14(2)(*a*), any amount (even the entire amount) of Rs 200,000 which has been received as dividend by Hungerford, Ltd., will go untaxed

By the amending Act of 1939, this Sec 14(2)(*a*) has been omitted Some consequential changes have now been made, *viz.*, section 48(1) and section 49B and 49C.

Section 14(2)(a) of the Old Act.

It runs as follows :—

"The tax shall not be payable by an assessee in respect of any sum which he receives by way of dividends as a shareholder in a company where the profits or gains of the company have been assessed to income-tax."

The idea behind this provision was that there must not occur double taxation. That is, it must not so happen that once the company pays income-tax and again on the same income, the shareholder of the company is made to pay. Hence it was provided that the shareholder shall not pay if the company has paid (*i.e.*, taxed).

The wordings in the section were rather loose and Hungerford Trust Company (1935 I.T.R. 65, 1936 P.C. 219), took the fullest advantage by contending that the company (T.M.Co.) having been taxed (though it was taxed

only on Rs. 70,000 .say, out of the total receipts of Rs. 2,00,000) the payee company (Hungerford Trust) shall not pay again. The Privy Council also held the same view and although the payee company received dividends from the partly untaxed dividends of the payer company, still, no tax was payable by the Hungerford company as the T. M. Co. already paid though only on a portion—the other portion being agricultural, income-tax free security dividends, and income arising outside British India.

The decision of the High Court and the Privy Council naturally raised a dissatisfaction. By the Amendment Act of 1939, this section 14(2)(*a*) has been deleted.

This deletion renders the Hungerford decision obsolete and that in a case like that of T.M.'s accounts, its assessment will be guided by the general principles of Income Tax Act in the absence of specific provision for such a case.

(1) The author in the 1st edition of this book put forward the following views :-

"A Tea Company, an assessee as such, is taxed on 40% of its profits; but when a shareholder is assessed as an individual, the dividends received must be taxed on the full 100% (no matter whether it is tea or coal or sugar dividend), for the dividend is taxable under section 12. If the concession enjoyed by the source (e.g.,Tea Company) continues to be enjoyed by every body in receipt of money from that source, then an absurd position may arise, *e.g.*, University being exempt from tax, all teachers getting salary from the exempted earnings of the University should, according to the above, enjoy exemption. In short, concession granted to a tea company under section 2, cannot be extended to its shareholders who must be assessed under section 12".

This seems to be a very reasonable view particularly as it obtains support from a parallel case, *viz.*, an agriculturist gets exemption from tax on agricultural income but when dealers bring it into the market and sell it, the

income no more remains agricultural income, it becomes a business income.

Even the same zamindar of Kirlampudi (Sec. 2) could not claim *arrear rent* (which is agricultural income) because he took a pronote against it and thus was deemed to have converted it to a *loan* pure and simple.

Mr. Manu Subedar, in the Assembly debates, said :—

"Hitherto, under section 14(2)(*a*), an assessee would not be taxed on a dividend received by him outside British India on the assumption that the company had paid the necessary tax. Now the dividend will be added to the income on which the assessment will be taken, and, under section 18(5) credit will be given to him. But the credit will be given to him only to the extent to which the income in the hands of the company has paid the tax. Sir, in other words the position will be this, that if the company had any tax-free source of income, such as agricultural incomes, tax-free securities or accumulated depreciation allowances, then this income which was exempt, which was by law exempt in the hands of the company, will now be taxable in the hands of the individual shareholder. The effect of this will be that the shareholders of tea companies, unless a specific provision is made for them, and also of zamindari companies and other companies, whose source of income is agricultural, will be liable to pay tax, whereas they were exempt before."

The position explained above by Mr. Manu Subedar is quite correct but we have been told that the executive instructions will be issued to meet the above anomaly or difficulty. The solution lies in the percentage basis of working out, *viz.*, dissecting the dividend in the hands of the shareholder and there the shareholder will be assessed on say business profits, taxed dividends, etc., ignoring the non-taxable items like agricultural income, etc. The following example will roughly indicate the solution.

Illustration 65.

(2) The other view of the author in the absence of section 14(2)(*a*) is that this most complicated question should be answered in the following manner :—

T. M.'s income

(1) Agricultural income ...	Rs. 40,000
(2) Interest on sterling investments arising in U.K. and not brought into British India ...	70,000
(3) Tax-free securities ...	20,000
(4) Business profits ...	45,000
(5) Taxed Dividends gross ...	25,000
	Rs. 200,000

If H receives only Rs. 50,000 as dividend out of this Rs. 200,000 then proportionately he has received from :

(1) Agricultural income	Rs. 10,000
(2) Interest on sterling, etc. ...	17,500
(3) Dividends from tax-free securities ...	5,000
(4) Business profits ...	11,250
(5) Taxed dividends ...	6,250
	Rs. 50,000

Out of the above, H will have to pay tax on business profits Rs. 11,250

and on taxed dividends Rs. 6,250

Item 1 will not at all come into the total income nor item 2. The item 3 will enter into the total income but will get the usual relief at the average rate. With regard to taxed items, credit under section 18(5) will be given.

The above working is based on the principle that the Income-tax which the T. M. Co., pays is not its own share of tax but the shareholder's share and as such H, being the shareholder (recipient), is to be treated as above given. It looks as if every subsequent recipient will get this rebate but in the opinion of the author this advantage should be restricted to the primary recipient only and not extend-

ed to the subsequent assessees who can have no ground to enquire about the character of the sources constituting the dividends (a portion of the original Rs. 200,000 dividends).

Otherwise, situation becomes really absurd, for, take the case of a registered firm. A registered firm makes a profit from its business and suppose this profit consists of income from :

(1) Agricultural income,

(2) House rent,

(3) Interest on securities,

(4) Merchanting or business profits.

We take the total profits and distribute between the partners - we do not have any authority to dissect the business profits. Even assuming that business profits are dissected, what treatment to give to the business loss? Shall we dissect that also instead of carrying it forward as business loss?

15. (1) The tax shall not be payable in respect of any sums paid by an assessee to effect an insurance on the life of the assessee or on the life of a wife or husband of the assessee or in respect of a contract for a deferred annuity on the life of the assessee or on the life of a wife or husband of the assessee, or as a contribution to any Provident Fund to which the Provident Funds Act, 1925, applies.

(2) Where the assessee is a Hindu undivided family, there shall be exempted under sub-section (1) any sums paid to effect an insurance on the life of any male member of the family or of the wife of any such member.

(3) The aggregate of any sums exempted under this section shall not, together with any sums exempted under the second proviso to sub-section (1) of section 7 and any sums exempted under sub-section (1) of section 58F, exceed in the case of an individual, one-sixth of the total income of the assessee, or six thousand rupees, whichever is less, and in the case of a Hindu undivided family, one-sixth of the total income of the assessee, or twelve thousand rupees, whichever is less.

NOTE.—(1) Tax shall not be payable in respect of Life Insurance payments up to 1/6 of the total income of the assessee not exceeding Rs. 6,000 in the case of an individual and Rs. 12,000 in the case of a H. U. F.

(2) Life Insurance premium payments and provident fund payments of the year together must not exceed 1/6.

(3) The amount of tax on the above payments at the average rate of tax will be deducted from the tax payable on the total income.

16. (1) In computing the total income of an assessee—

(a) any sums exempted under the second proviso to sub-section (1) of section 7, the second and third provisos to section 8, sub-section (2) of section 14 and section 15 shall be included;

(b) when the assessee is a partner of a firm, then, whether the firm has made a profit or a loss, his share (whether a net profit or a net loss) shall be taken to be any salary, interest, commission or other remuneration payable to him by the firm in respect of the previous year increased or decreased respectively by his share in the balance of the profit or loss of the firm after the deduction of any interest, salary, commission or other remuneration payable to any partner in respect of the previous year.

Provided that if his share so computed is a loss, such loss may be set off or carried forward and set off in accordance with the provisions of section 24;

(c) all income arising to any person by virtue of a settlement or disposition whether revocable or not, and whether effected before or after the commencement of the Indian Income-tax (Amendment) Act, 1939, from assets remaining the property of the settlor or disponer, shall be deemed to be income of the settlor or disponer, and all income arising to any person by virtue of a revocable transfer of assets shall be deemed to be income of the transferor:

Provided that for the purposes of this clause a settlement, disposition or transfer shall be deemed to be

revocable if it contains any provision for the re-transfer directly or indirectly of the income or assets to the settlor, disponer or transferor, or in any way gives the settlor, disponer or transferor a right to reassume power directly or indirectly over the income or assets;

Provided further that the expression 'settlement or disposition' shall for the purposes of this clause include any disposition, trust, covenant, agreement, or arrangement, and the expression 'settlor or disponer' in relation to a settlement or disposition shall include any person by whom the settlement or disposition was made;

Provided further that this clause shall not apply to any income arising to any person by virtue of a settlement or disposition which is not revocable for a period exceeding six years or during the lifetime of the person and from which income the settlor or disponer derives no direct or indirect benefit but that the settlor shall be liable to be assessed on the said income as and when the power to revoke arises to him.

(2) For the purposes of inclusion in the total income of an assessee any dividend shall be deemed to be income of the previous year in which it is paid, credited or distributed or deemed to have been paid, credited or distributed to him, and shall be increased by the amount of income tax (but not super-tax) payable thereon calculated at the rate applicable to the total income of a company for the financial year in which the dividend is paid, credited or distributed or demeed to have been paid, credited or distributed:

Provided that when any portion of the profits and gains of the company out of which such dividend has been paid, credited or distributed or deemed to have been paid, credited or distributed was not liable to income-tax in the hands of the company, the income-tax to be added under this section shall be calculated upon only such proportion of the dividend as the amount of the profits and gains of the company liable to income-tax bears to the total profits and gains of the company.

(3) In computing the total income of any individual for the purpose of assessment, there shall be included—

(a) so much of the income of a wife or minor child of such individual as arises directly or indirectly—

(i) from the membership of the wife in a firm of which her husband is a partner;

(ii) from the admission of the minor to the benefits of partnership in a firm of which such individual is a partner;

(iii) from assets transferred directly or indirectly to the wife by the husband otherwise than for adequate consideration or in connection with an agreement to live aprt; or

(iv) from assets transferred directly or indirectly to the minor child, not being a married daughter, by such individual otherwise than for adequate consideration; and

(b) so much of the income of any person or association of persons as arises from assets transferred otherwise than for adequate consideration to the person or association by such individual for the benefit of his wife or a minor child or both.

Determination of total income: —

In the total income, shall be included

(1) sums exempted under sec. 7(1) proviso,

(2) ,, ,, ,, ,, & second and third provisos,

(3) ,, ,, ,, 14(2),

(4) ,, ,, ,, 15,

(5) sums under secs. 16(1)(*b*), 16(1)(*c*), 16(2), 16(3)(*a*), 16(3)(*b*).

(*a*) When the assessee is a partner of a firm then, whether the firm has made a profit or less, his share, *viz.*, salary, interest, commission, etc. [16(1)(*b*).]

(*b*) All income arising from a settlement or disposition, from assets remaining the property of the settlor [16(1)(*c*).]

we intend, and, I am, therefore, quite willing to make that meaning clear by adding at the end of that clause, "but that the settlor shall be liable to be assessed on the said income as and when the power to revoke arises to him," because that is the intention by way of construction of the very more or less compendious expression used by us; and I ask leave to add these words. As the explanation goes, that is, the intention of the clause which stands by itself,—the words being, "but that the settlor shall be liable to be assessed on the said income as and when the power to revoke arises to him". (Mr. *B. J. Desai*, Assembly Debates).

NOTE.—(1) Section 16 provides that if there has been an agreement that the wife will live apart, then aggregation will not take place It seems one can claim this advantage even if there has not been any judicial separation; for the matter of that, a resident may even argue that on the ground of wife's health, the wife is living in England or in Kashmir and this also may be considered as living apart. But is this agreement?

(2) The section clearly provides that where transference of asset has been made even indirectly to wife, aggregation will take place But surely it will not be within the competence of the I T O to claim aggregation in the case where the wife has got the property as gift from her husband's brother to whom this property was absolutely given by the husband.

(3) Transference directy or indirectly implies an intention on the part of the giver but in this case, the husband has by his action, *viz.*, absolute gift to his brother, shows definitely the contrary intention. Where absolute gift has not been made, the expression "indirectly" will do its mischief.

17 (1) Where a person is not resident in British India, and is a British subject as defined in section 17 of the British Nationality and Status of Aliens Act, 1914, or a subject of a State in India or Burma, the tax, including super-tax, payable by him or on his behalf on his total income shall be an amount bearing to the total amount of the tax including super-tax which would have been

payable on his total world income had it been his total income the same proportion as his total income bears to his total world income; and in the case of any other non-resident person, the income-tax payable by him or on his behalf on his total income shall be at the maximum rate and the super-tax payable thereon shall be an amount bearing to the total amount of super-tax which would have been payable on his total world income had it been his total income the same proportion as his total income bears to his total world income.

(2) Where there is included in the total income of any assessee any income (including income from a share in an unregistered firm, if assessed as such) exempted from tax by or under the provisions of this Act, the income-tax excluding super-tax payable by the assessee shall be an amount bearing to the total amount of the income-tax excluding super-tax which would have been payable on the total income had no part of it been exempted the same proportion as the unexempted portion of the total income bears to the total income.

NOTE.--(1) Non residents have been divided into two classes

(*a*) British subjects and subjects of Indian states or Burma

(*b*) All others.

Regarding (*a*) British subjects, the rate is fixed by the total world income at the Indian rate.

Illustration 66.

Income in British India ...	...	Rs. 1,000
Income abroad ..	...	Rs. 6,000
Total world income	...	Rs. 7,000

Income-tax payable on this is Rs. 320. Average rate is 8·79 pies.

Hence, Income-tax payable $\frac{1,000}{7,000} \times 320 =$ Rs. 45-11-0

Regarding (*b*) above, the rate for income-tax is the maximum rate, *i.e.*, 30 pies whatever the income may be.

(2) In the matter of super-tax, treatment for (*a*) and (*b*) above is the same on the basis of the total world income:

Illustration 67.

Income in British India	... ...	Rs. 10,000
Income abroad	. ...	Rs. 20,600
Total world income	...	Rs. 30,600

Income-tax payable on this = Rs. 3,617-3-0. The average rate 22·69.

Super tax payable = Rs. 350.

Hence, **super-tax** payable = $\frac{10,000}{30,600} \times 350$ = Rs 114-6-0.

Sec. 18. (2) Any person responsible for paying any income chargeable under the head "Salaries" shall, at the time of payment, deduct income-tax and super-tax on the amount payable at a rate representing the average of the rates applicable to the estimated total income of the assessee under this head:

Provided that such person may, at the time of making any deduction, increase or reduce the amount to be deducted under this sub-section for the purpose of adjusting any excess or deficiency arising out of any previous deduction or failure to deduct.

(2-A) Notwithstanding anything hereinbefore contained, for the purpose of making the deduction under sub-section (2), there shall be included in the amount payable any income chargeable under the head "Salaries" which is payable to the assessee out of India by or on behalf of the Crown, and the value in rupees of such income shall be calculated at the prescribed rate of exchange

(2-B) Any person responsible for paying any income chargeable under the head "Salaries" to a person not resident in British India shall at the time of payment deduct income-tax at the maximum rate and also super-tax at the rate or rates applicable to the estimated income of the assessee under this head.

(3) The person responsible for paying any income chargeable under the head "Interest on securities" shall, unless otherwise

prescribed in the case of any security of the Central Government at the time of payment, deduct income-tax but not super-tax on the amount, of the interest payable at the maximum rate:

Provided that where the Income-tax Officer gives a certificate in writing (which certificate he shall give in every proper case on the application of the assessee) that to the best of his belief the total income or the total world income of a recipient will be less than the minimum liable to income-tax or will be liable to a rate of income-tax less than the maximum rate, the person responsible for paying any income referred to in this sub-section or in sub-section (2-B), as the case may be, to such recipient shall, until such certificate is cancelled by the income-tax Officer, pay the income without deduction or deduct the tax at such less rate, as the case may be.

(3-A) Any person responsible for paying to a person not resident in British India any interest not being 'Interest on Securities', or any other sum chargeable under the provisions of this Act, shall, at the time of payment, unless he is himself liable to pay income-tax thereon as an agent, deduct income-tax at the maximum rate.

(3-B) Where the Income-tax Officer has reason to believe that the total world income of any person residing out of British India to whom any interest not being 'Interest on Securities' or any other sum chargeable under this Act is payable, will in any year exceed the maximum amount which is not chargeable with super-tax under the law for the time being in force, he may, by order in writing, require the person responsible for making such payments to such person to deduct at the time of payment super-tax at the rates determined by the Income-tax Officer to be applicable to the total world income of such person in that year.

(3-C) Where the person responsible for paying any interest not being 'Interest on Securities' or any other sum chargeable under this Act to any person makes to that person in any year payments exceeding in the aggregate the maximum amount which is not chargeable with super-tax under the law for the time being in force, the person responsible for making such payments shall, if he has not reson to believe that the recipient is resident in British India, and no order under sub-section (3-B) has been received in respect of such recipient, deduct at the time of payment super-tax on the amount by which the total amount of such pay-

ments exceeds the maximum amount not chargeable with super-tax at the rate applicable to such excess.

(3-D) Where the Income-tax Officer has reason to believe that any person, who is a shareholder in a company, is resident out of British India and that the total world income of such person will in any year exceed the maximum amount which is not chargeable to super-tax under the law for the time being in force, he may, by order in writing, require the principal officer of the company to deduct at the time of payment of any dividend from the company to the shareholder in that year super-tax at such rate as the Income-tax Officer may determine as being the rate applicable in respect of the income of the share-holder in that year.

(3-E) If in any year the amount of any dividend or the aggregate amount of any dividends paid to any shareholder by a company (together with the amount of any income-tax payable by the company in respect thereof) exceeds the maximum amount of the total income of a person which is not chargeable to super-tax under the law for the time being in force, and the principal officer of the company has no reason to believe that the shareholder is resident in British India, and no order under sub-section (3-D) has been received in respect of such shareholder by the principal officer from the Income-tax Officer, the principal officer shall at the time of payment deduct super-tax on the amount of such excess at the rate which would be applicable under the law for the time being in force if the amount of such dividend or dividends (together with the amount of such income-tax as aforesaid) constituted the whole total income of the shareholder.

(4) All sums deducted in accordance with the provisions of this section shall, for the purpose of computing the income of an assessee, be deemed to be income received.

(5) Any deduction made in accordance with the provisions of this section and any sum by which a dividend has been increased under sub-section (2) of section 16 shall be treated as a payment of income-tax or super-tax on behalf of the person from whose income the deduction was made, or of the owner of the security or of the shareholder, as the case may be, and credit shall be given to him therefor in the assessment, if any, made for the following year under this Act:

Provided that, if such person or such owner obtains, in accordance with the provisions of this Act, a refund of any portion of

the tax so deducted, no credit shall be given for the amount of such refund:

Provided further that where such person or owner is a person whose income is included under the provisions of clause (C) of sub-section (1) or sub-section (3) of section 16, section 44D or section 44E in the total income of another person such other person shall be deemed to be the person or owner on whose behalf payment has been made and to whom credit shall be given in the assessment for the following year.

(6) All sums deducted in accordance with the provisions of this section shall be paid within the prescribed time by the person making the deduction to the credit of the Central Government or as the Central Board of Revenue directs.

(7) If any such person does not deduct or after deducting fails to pay the tax as required by or under this section, he, and in the cases specified in sub-sections (3-D) and (3-E) the company of which he is the principal officer shall, without prejudice to any other consequences which he or it may incur, be deemed to be an assessee in default in respect of the tax:

Provided that the Income-tax Officer shall not make a direction under sub-section (1) of section 46 for the recovery of any penalty from such person unless satisfied that such person has wilfully failed to deduct and pay the tax.

(8) The power to levy by deduction under this section shall be without prejudice to any other mode of recovery.

(9) Every person deducting income-tax or super-tax in accordance with the provisions of sub-section (3), (3-A), (3-B), (3-C), (3-D) or (3-E) shall, at the time of payment of the sum from which tax has been deducted, furnish to the person to whom such payment is made a certificate to the effect that income-tax or super-tax has been deducted, and specifying the amount so deducted, the rate at which the tax has been deducted, and such other particulars as may be prescribed.

Payment by deduction at source.

SS(2), Any person responsible for paying any income chargeable under "salaries" will deduct tax (I.T. and S.T.) from salaries at an average rate (calculated on the total income from "salaries").

SS(2-A), Tax shall be deducted at source on "salaries" paid out of India by or on behalf of Government.

SS(2-B), I.T. to be deducted on 'salaries' at the maximum rate in the case of non-residents. S.T. to be deducted at the rate applicable to the estimated income from 'salaries'.

SS(3), Deduction of Income-tax (S.T. not to be deducted) from interest on securities shall be made at the maximum rate fixed by the Finance Act.

The I.T O may issue an exemption certificate on the production of which the paying authority shall deduct tax at the rate specified in the Certificate from 'salaries' and interest on securities

SS(3-A), In the case of non residents, deduction of I T. to be made at source at the maximum rate from any interest other than interest on securities or any other sum chargeable under the Act

SS(3-B), In the case of non residents, deduction of S.T. to be made at source at the rate applicable to the world income from any interest other than interest on securities or any other sum chargeable under the Act, as per I.T.O.'s order.

SS(3 C), In the case of non residents, where no such order has been received, the paying officer shall deduct super-tax on interest other than interest on securities or any other sum chargeable under the Act at the rate applicable to the amount of such payments

SS(3-D). In the case of non resident share-holders, deduction of Super-tax is to be made at the time of payment, at the rate applicable to the income of shareholder from dividends as per I T O.'s order.

SS(3-E), In the case of non-residents, where no such order has been received, the principal officer shall deduct

super-tax on such dividends at the rate applicable to gross dividends paid.

SS(4), All the deductions are to be included in the total income.

SS(5), Tax deducted will be considered a credit in the name of the share-holder.

SS(6), Tax deducted, shall be paid within the prescribed time to the Government.

SS(7), If tax has not been deducted by the appropriate person under 3-D or 3-E, then, the company of which he is the principal officer shall be deemed to be the assessee.

SS(8), The power to effect these deductions does not affect other modes of recovery.

SS(9), The person who deducts is required to give a certificate of deduction. The forms of such certificate are in the rule 13, 13-A, 13-B, 13-C.

NOTE —(1) The words "person responsible for paying" used in section 18(2) should be interpreted as referring to the person entrusted by the employer with the duty of paying salaries and not to the employer himself if he does not himself pay them and this applies also to the case of an employee entrusted by an employer with the payment of his (the employee's) own salary. (Para. 76, I.T.M.).

(2) Any person required to make a deduction under section 18 who fails to do so may himself under sub-section (7) be deemed to be an assessee in default in respect of the tax while he is also liable to be prosecuted for an offence punishable under section 51 (a). A penalty can also be imposed under section 46(1) for such default if the Income-tax Officer is satisfied that such person has wilfully failed to deduct and pay the tax. (Para. 76, I.T.M.).

(3) (a) Security includes stocks and shares.

(b) "Government Security means Promissory notes (including Treasury bills), Stock-certificates, bearer bonds and all other securities issued by the Central Government or by any Provincial Government in respect of any loan contracted either before or after the passing of this Act but does not include a Currency note."

Sec. 19. In the case of income in respect of which provision is not made under section 18 for deduction of income-tax at the time of payment, and in any case where income-tax has not been deducted in accordance with the provisions of section 18, income-tax shall be payable by the assessee direct.

Where income-tax has not been deducted at source, the tax shall be paid direct.

Income means income, profits and gains.

Sec. 19A. The principal officer of every company shall, on or before the 15th day of June in each year, furnish to the prescribed officer a return in the prescribed form and verified in the prescribed manner of the names and of the addresses, as entered in the register of shareholders maintained by the company, of the shareholders to whom a dividend or aggregate dividends exceeding such amount as may be prescribed in this behalf has or have been distributed during the preceding year and of the amount so distributed to each such shareholder.

Supply of information regarding dividends.

The principal officer of every Company shall, on or before 15th June, furnish the Income tax authorities in a prescribed manner the names, addresses and amounts of dividends paid during the preceding year if the amount exceeds Rs. 5,000.

Penalty for not furnishing—Section 51.

Penalty for furnishing false return Section 177, I.P.C.

Sec. 20. The principal officer of every company shall, at the time of distribution of dividends, furnish to every person receiving a dividend a certificate to the effect that the company has paid or will pay income-tax on the profits which are being distributed, and specifying such other particulars as may be prescribed.

Certificate by company.

The Principal officer of every Company shall supply every person receiving a dividend a certificate to the effect

that the Company has paid or will pay Income-tax on the profits distributed.

Penalty for not supplying—Section 51.

This certificate is essential for claiming refund by a shareholder.

Sec. 20A. The person responsible for paying any interest not being "Interest on securities" shall, on or before the fifteenth day of June in each year, furnish to the prescribed officer a return in the prescribed form and verified in the prescribed manner of the names and addresses of all persons to whom during the previous financial year he has paid interest or aggregate interest exceeding such amount not being less than four hundred rupees as may be prescribed in this behalf, together with the amount paid to each such person.

Supply of information regarding interest.

The person responsible for paying interest (not being interest on securities) shall supply the authorities with a Return in case the aggregate interest exceeds Rs. 400.

Penalty for not supplying information is prosecution under Sec 51.

Sec. 21. The prescribed person in the case of every Government office, and the principal officer or the prescribed person in the case of every local authority, company or other public body or association, and every private employer shall prepare, and, within thirty days from the 31st day of March in each year, deliver or cause to be delivered to the Income-tax Officer in the prescribed form and verified in the prescribed manner, a return in writing showing—

(a) the name and, so far as it is known, the address, of every person who was receiving on the said 31st day of March, or has received or to whom was due during the year ending on that date, from the authority, company, body, association or private employer, as the case may be, any income chargeable under the head "Salaries" of such amount as may be prescribed:

(b) the amount of the income so received or so due by each

such person, and the time or times at which the same was paid or due, as the case may be;

(c) the amount deducted in respect of income-tax and super-tax from the income of each such person.

Annual Return.

Every employer, private, Governmental or otherwise shall supply by 30th April a Return to the Income-tax Department showing—

(*a*) name, address, etc., of every person chargeable under the head "Salaries."

(*b*) the amount of the income so received or so due by each such person and the time of payment or its date.

(*c*) the amount of income-tax deducted from each.

Penalty for not supplying—Section 51.

Return of all employees earning Rs. 1,600 or over.

Return to be delivered within 30 days from 31st March each year. This refers to every employer.

Sec. 22. (1) The Income-tax Officer shall, on or before the 1st day of May in each year, give notice, by publication in the press and by publication in the prescribed manner, requiring every person whose total income during the previous year exceeded the maximum amount which is not chargeable to income-tax to furnish, within such period not being less than sixty days as may be specified in the notice, a return, in the prescribed form and verified in the prescribed manner, setting forth (along with such other particulars as may be required by the notice) his total income and total world income during that year:

Provided that the Income-tax Officer may in his discretion extend the date for the delivery of the return in the case of any person or class of persons;

(2) In the case of any person whose total income is, in the Income-tax Officer's opinion, of such an amount as to render such person liable to income-tax, the Income-tax Officer may serve a notice upon him requiring him to furnish, within such period, not

being less than thirty days, as may be specified in the notice, a return in the prescribed form and verified in the prescribed manner setting forth (along with such other particulars as may be provided for in the notice) his total income and total world income during the previous year:

Provided that the Income-tax Officer may in his discretion extend the date for the delivery of the return;

(3) If any person has not furnished a return within the time allowed by or under sub-section (1) or sub-section (2), or having furnished a return under either of those sub-sections, discovers any omission or wrong statement therein, he may furnish a return or a revised return, as the case may be, at any time before the assessment is made.

(4) The Income-tax Officer may serve on any person who has made a return under sub-section (1) or upon whom a notice has been served under sub-section (2) a notice requiring him, on a date to be therein specified, to produce, or cause to be produced, such accounts or documents as the Income-tax Officer may require:

Provided that the Income-tax Officer shall not require the production of any accounts relating to a period more than three years prior to the previous year.

(5) The prescribed form of the returns referred to in sub-sections (1) and (2) shall, in the case of an assessee engaged in any business, profession or vocation, require him to furnish particulars of the location and style of the principal place wherein he carries on the business, profession or vocation and of any branches thereof, the names and addresses of his partners, if any, in such business, profession or vocation and the extent of the share of the assessee and the shares of all such partners in the profits of the business, profession or vocation and any branches thereof.

Return of Income.

Sub-section (1)—A public notice to be published every year.

(*a*) I.T.O. shall give notice requiring every person to supply a return of his total income.

(*b*) It contemplates a general notice to be published on or before 1st May each year.

(*c*) Default in complying with the notice will attract section 28. It cannot bring to action section 23(4) or section 51.

(*d*) Form of notice is prescribed by rule 18-A.

Sub-section (2)—Individual notice, if necessary. Notice under 22(2) is now normally optional with I.T.O.

(*a*) It provides for notice to particular assessees if necessary. I.T.O. shall give at least 30 days time to supply a Return.

In Kajori Mal Kalyan Mal, *vs.* C.I.T., U.P., 1930, 3 I.T.C. 451, it was decided that if the minimum time (*i.e.*, 30 days) is not given, the notice is illegal.

(*b*) For a person carrying on business at different centres, separate notices under section 22(2) asking for separate Returns for each branch are not required (Lachman Parsad Babu Ram, Allahabad, 1930, A.I.R. 49)

The I.T.O. of the principal place of business can assess according to the best of his judgment. It is not necessary for him to accept a report of the I.T.O. of his branch office and it is not obligatory either to refer a matter back to the I.T.O. of the branch for further investigation if in his judgment it is unnecessary. (Lachman Prasad, 1930, A.I.R., 49, Allahabad).

(*c*) Default in complying with section 22(2) will attract section 28 or section 51 and section 23(4) if no evidence is produced.

Sub-section (3)—Revised Return allowed:

If any person has not furnished a Return within the time allowed under section 22(1) or 22(2) or in case of any omission or error, a revised return can be submitted any time before the assessment is made and under section 22(3), this will be deemed to be a Return made in due time.

Income-tax Officer may or may not accept a revised return according as he considers it to be a bona fide revi-

sion. If an assessee submits a revised return just when he discovers that a deliberate omission or flaw has been detected, the I.T.O. will not accept such a revised return.

Sub-section (4)—Income-tax Officer can ask accounts or documents to be produced.

The Income-tax Officer can ask anybody specified under section 22(1) and 22(2) to produce on a fixed date such accounts or documents as the Income-tax Officer requires, but cannot enforce production of accounts relating to a period more than 3 years prior to the previous year.

NOTE.—(1) Failing to comply with section 22 will attract sections 28, 51, 23(3), 23(4).

(2) A notice can be issued under section 22(4) at any stage. It need not be after the assessee has been called upon to furnish a return and prior to his actually furnishing return (Mohamad Hayat Haji Muhammad *vs.* C.I.T., Punjab, 1929, 3 I.T.C. 67 and Pallu Mall Bholanath, 1933, I T.R. 235.)

(3) In 1937-38 assessment, accounts can be summoned for the years ended 31st March, 1936, 1935, 1934; but

(4) Documents (not accounts) of any time can be called.

In the case Gopi Nath Naik *vs.* C.I.T., U.P., 1936, I.T.R. 1. the assessee submitted a Return under section 22(2). The return was not accepted. He was assessed at Rs. 100,450 including Rs. 100,000 from money lending business. He appealed to the Commissioner who set aside the assessment and directed a fresh assessment. The I.T.O. issued notice under section 23(2) for producing evidence to prove accounts of money-lending business. The assessee could not explain accounts and omissions. A fresh return was submitted. He did not substantiate the return by evidence. The accounts were found to be incomplete and unreliable. He estimated the income to be

8 per cent. on the money invested, after making enquiries behind the back of the assessee from the people of the locality. The assessee applied for revision and for reference to High Court. The Commissioner refused to refer but the High Court required the case to be referred.

Justice Niamatullah in this case observed: -

"The important question, which arises in this connection is whether if the return is found to be incorrect or incomplete and the assessee produces no evidence, it is open to the Income-tax Officer to assess the income in any manner he thinks fit, or whether the assessment must proceed on some 'evidence'. It is argued by the learned advocate for the income-tax department, that there is nothing in section 23(3) which makes it incumbent on the Income-tax Officer to base his assessment on "evidence" whatever it may mean It is pointed out that Section 23(3), as it stands, merely makes it obligatory that the evidence, which the assessee may produce or the Income Tax Officer may call for, should be heard, but that if no such evidence is produced by the assessee nor is any called for, by the Income-tax Officer himself, it is open to him to make the assessment on such basis as he thinks fit If this line of argument is accepted, an assessment, made under Section 23(3), will, in many cases, be virtually, an assessement under Section 23(4) It seems to me that, where the Income Tax Officer acts under Section 23(3), the assessment must be based on "evidence" .

"The assessee alleges by his return that his assessable income is what is stated therein. But the Income Tax Officer denies that fact. The onus is undoubtedly on the assessee, if he maintains that his return is correct; but if the return is set aside and the Income Tax Officer puts forward an affirmative case that the assessee's income is more and gives a definite figure, the onus is on him to support his case. It cannot be said that the onus lies on the assessee not only to substantiate his return but also to disprove every allegation or assertion which the Income Tax Officer may choose to make. This is clear from Section 23(3) which makes it incumbent on the Income Tax Officer to make the assessment "after hearing such evidence as such person may produce and such other evidence as the Income Tax Officer may require on specified points". That part of the section obviously means that the Income

Tax Officer shall hear the evidence which the assessee may produce in support of his return, and that if the return or the evidence in support thereof is not accepted, the Income Tax Officer shall hear such further evidence as may be necessary for making the assessment. The words "may require" refer to his requirements in making the assessment and not to evidence which he may call for. It is clear to my mind that the section contemplates that if the evidence adduced by the assessee is not accepted, the Income Tax Officer must have recourse to other evidence to base his assessment on. It does not place the Income Tax Officer absolutely on the defensive, so that, if the assessee's attempt to substantiate his return fails, the Income Tax Officer can assume the income of the assessee to be anything which his imagination may lead to."

"My answer to the second question, therefore, is that the Assistant Commissioner was authorised under section 13 of the Income Tax Act and also otherwise to make private enquiries, but he is not permitted to take the result of such private enquiries into account in making the assessment without giving an opportunity to the assessee to meet them."

As Justice Bajpai differed from the above, the case was referred to Sulaiman C. J. who observed:

"Sub-section (3) of section 23 speaks of the Income Tax Officer hearing such other evidence as he may require that is to say, evidence other than that produced by the assessee which the Income Tax Officer considers necessary to take, but the word used is "evidence" and not other words, like, information. It would seem to follow *prima facie* that what the sub-section authorizes the Income Tax Officer to do is to take evidence in rebuttal of the evidence produced by the assessee and which *prima facie* should be taken in the presence of the assessee and of which the assessee should have knowledge in order that he may be able to meet such evidence."

"It, therefore, seems to me that the enquiries made by the Income Tax Officer from the people of the district, after proceedings under section 23(3) had started, of which no notice had been given to the assessee, were illegal and not authorized by sub-section (3). Similarly, the enquiries made by the Assistant Commissioner during the hearing of the appeal behind the back of the appellant were not justified by the provisions of Sub-section (3) and the

result of such private enquiries should not have been made the basis of any assessment."

The Chief Justice then sent the case back to the bench and the bench passed the following order:—

"(1) The estimate of 11 lakhs as the capital invested by the assessee is based partly on such evidence as the Assistant Commissioner was in law empowered to act upon and partly on evidence which he was not empowered by law to act upon.

(2) The Assistant Commissioner was not authorised under Section 13 of the Income Tax Act or otherwise to make private enquiries and to take the result of such enquiries into account in making the assessment."

The Select Committee observed:

In the proposed new sub-section (1) of section 28 of the Act we have provided that accidental failure to furnish the returns referred to shall not be visited with penalty; and by our changes in the proviso to the sub-section we have restricted the penalty for failure to comply with the general notice under sub-section (1) of the section 22 of the Act to assessees whose income is not less than three thousand five hundred rupees, and we have reduced to a maximum of twenty-five rupees the penalty for failure to comply with the notice under Section 22(2) of the Act where the person failing is proved to have no income liable to tax. We have omitted clause (c) of the proviso contained in the Bill as introduced in the belief that it is unnecessary.

The fact that audit has not been completed is no ground for not filing return in time (Manbhum Transport Co. *vs.* C.I.T. Bihar, 6 I.T.C. 203).

The assessee need not sign himself. Any person having power to bind the assessee can sign.

A power of attorney which empowers an agent to "File suits, application, plaints, memorandum of appeal, written statements and affidavits" on behalf of the Principal before Civil Courts, Revenue Courts and other Government departments does not automatically empower agent to file a return. (Rajah Sayyid Mohammad Mehdi *vs.* C.I.T., U.P. (Oudh), 1935, I.T.R. 202.)

Sec. 23. (1) If the Income-tax Officer is satisfied without requiring the presence of the assessee or the production by him of any evidence that a return made under section 22 is correct and complete, he shall assess the total income of the assessee, and shall determine the sum payable by him on the basis of such return.

(2) If the Income-tax Officer is not satisfied without requiring the presence of the person who made the return or the production of evidence that a return made under section 22 is correct and complete, he shall serve on such person, a notice requiring him, on a date to be therein specified, either to attend at the Income-tax Officer's office or to produce, or to cause to be there produced, any evidence on which such person may rely in support of the return.

(3) On the day specified in the notice issued under sub-section (2), or as soon afterwards as may be, the Income-tax Officer, after hearing such evidence as such person may produce and such other evidence as the Income-tax Officer may require, on specified points, shall, by an order in writing, assess the total income of the assessee, and determine the sum payable by him on the basis of such assessment.

(4) If any person fails to make the return required by any notice given under sub-section (2) of section 22 and has not made a return or a revised return under sub-section (3) of the same section or fails to comply with all the terms of a notice issued under sub-section (4) of the same section or, having made a return, fails to comply with all the terms of a notice issued under sub-section (2) of this section, the Income-tax Officer shall make the assessment to the best of his judgment and determine the sum payable by the assessee on the basis of such assessment and, in the case of a firm, may refuse to register it or may cancel its registration if it is already registered:

Provided that the registration of a firm shall not be cancelled until fourteen days have elapsed from the issue of a notice by the Income-tax Officer to the firm intimating his intention to cancel its registration.

(5) Notwithstanding anything contained in the foregoing sub-sections, when the assessee is a firm and the total income of the firm has been assessed under sub-section (1), sub-section (3) or sub-section (4), as the case may be,—

(a) in the case of a registered firm, the sum payable by the firm itself shall not be determined but the total income of each partner of the firm, including therein his share of its income, profits and gains of the previous year, shall be assessed and the sum payable by him on the basis of such assessment shall be determined:

Provided that if such share of any partner is a loss it shall be set off against his other income or carried forward and set off in accordance with the provisions of section 24:

Provided further that when any of such partners is a person not resident in British India, his share of the income, profits and gains of the firm shall be assessed on the firm at the rates which would be applicable if it were assessed on him personally, and the sum so determined as payable shall be paid by the firm; and

(b) in the case of an unregistered firm, the Income-tax Officer may instead of determining the sum payable by the firm itself proceed in the manner laid down in clause (a) as applicable to a registered firm, if, in his opinion, the aggregate amount of the tax including super-tax, if any, payable by the partners under such procedure would be greater than the aggregate amount which would be payable by the firm and the partners individually if the firm were assessed as an unregistered firm.

In Bishnu Priya Chowdhurani's case A I R 1921, Cal. 337, the assessee submitted return in which it was stated that a particular source yielded no income that year The I T O wanted him to prove this statement. Before the High Court it was accepted that the onus of proof lay on the Income Tax Department. The assessment was thus set aside.

In Rai Saheb Lala Jinda Ram, *vs.* C.I T. Lahore 3 I.T.C. 345, it was decided that the I.T.O. cannot be held to have no right to reverse the decision of his predecessors if the latter was found to be wrong or to reverse his own decision.

In Ramjidas Mahaliram, 1938, I.T.R. 265, the Calcutta High Court decided that when the I.T.O. accepts a return and makes an assessment under Section 23(1), the assessment is final subject however to sections 34 and 35.

Penalty:

A man returned his income. The I.T.O. does not accept it but computes his own figure on which assessment is made. It cannot *now* be contended by I.T.O. that a penalty of 1½ times would be levied. Note the words " that would have been avoided . . ."

From the above, it follows that if nothing is actually avoided, no case of penalty arises. Suppose under Sec. 34, an assessee is made to pay tax on the escaped income. Once the assessment is actually over, the question of avoidance cannot be raised and penalty levied. If penalty is to be levied, it must be levied before assessment is made.

Assessment.

23(1) **Assess, if return is correct.** (*Assessment on Return*)

If the Return made is correct the Income tax Officer shall assess the total amount and determine the tax payable

In Rajendra Nath Mukherjee *vs* C.I.T., Bengal, 1934. I.T.R. 71 it was decided that there was no express provision limiting the time within which assessment must be made

23(2) **If incorrect, the assessee to attend or to show evidence.**

If I.T.O. thinks the Return to be incorrect he shall serve on the person who made the Return a notice requiring him to attend or show evidence in support of his return.

23(3). **After evidence, assess.** (*Assessment on evidence*).

After hearing the evidence the Income-tax Officer shall assess by an order in writing.

23(4). **Best judgment assessment.** (*Assessment on default*).

When any Company or any person fails to make a Return or fails to produce books and documents or fails to show evidence in support of his Return, the Income-tax Officer shall make the assessment to the best of his judgment.

NOTE.—(1) This assessment is resorted to in cases of default under sections 22(2), 22(4), and 23(2).

(2) In case of above failure, such assessment is obligatory.

(3) Upon such assessment, Assessee can invoke section 27, *viz.*, for cancellation by the Income tax Officer of such assessment or he can make an appeal to A.C. under section 30.

Section 23(4). Best judgment assessment.

In C.I.T., C.P. and U.P. *vs.* Laxminarain Badridas, 1937, I T R 170 (P.C.), their Lordships of the Privy Council made certain observation for general guidance in the application of section 23(4). The duties of an Income-tax Officer have been laid down in this judgment in the following:—

"He must not act dishonestly or vindictively or capriciously because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment and for this purpose he must, their Lordships think, be able to take into consideration local knowledge and repute in regard to the assessee's circumstances and his own knowledge of previous returns by, and assessments of, the assessee and all other matters which he thinks will assist him in arriving at a fair and proper estimate; and though there must necessarily be guess-work in the matter, it must be honest guess-work. In that case too, the assessment must be to some extent arbitrary. Their Lordships think that the section places the officer in the position of a person whose decision as to amount is final and subject to no appeal but whose decision if it can be shown to have been arrived at without an honest exercise of judgment may be revised or reviewed by the Commissioner under the powers conferred upon that official by section 33."

In Jot Ram Sher Singh *vs.* C.I.T., U.P. (1934), I.T.R. 129, the Allahabad High Court observed :—

"That it should be borne in mind that an assessment under section 23(4) should not be influenced by a desire to punish the assessee for non-compliance with a notice under section 22 or 23, however culpable such non-compliance may be. To furnish the assessee by a so called best judgment assessment is wholly unwarranted."

If an assessment has been made under section 23(4), which, by the way, is obligatory in case of non-compliance by the assessee of sections 22(2), 22(4) and 23(2), the assessment will stand unless the assessee succeeds in satisfying the officer that :

(1) he was prevented by sufficient cause from making the return under section 22, or

(2) he did not receive the notice issued under section 22(4) or 23(2), or

(3) he had not a reasonable opportunity to comply with the terms of notices under sections 22(4) and 23(2), or

(4) was prevented by sufficient cause from complying with the terms of notices under section 22(4) and 23(2); otherwise the I.T O. shall cancel the assessment and proceed to make a fresh assessment under section 23.

It is perfectly true that the question whether the assessee was prevented by sufficient cause or not is always a question of fact. But in a recent case (Rajmani Devi's case, 1937, Allahabad, 1937, I.T.R. 631), the Allahabad High Court has held that it may as well be a question of law in different circumstances, *viz.*, where the notice under section 23(2) was illegal the non-compliance with which resulted in an assessment under section 23(4). If the notice is illegal, the assessee can stand on it to prove "sufficient cause." The above Rajmani Devi's case is

very important as it curtails **the powers of the Income tax Officer considerably. The Allahabad High Court has held** *that in section 23(2) the choice is with the assessee and not with the Income tax Officer to decide whether he should attend the office or produce evidence. Hence, in serving notice under section 23(2) if the Income tax Officer* does not give the assessee this choice the notice will be illegal. This view is very reasonable--the assessee knows best how to support his return most effectively.

In the case of I.T.O. *vs* Lucknow Sugar Works, 1935, I T R 322, I.T.Officer served a notice under section 22 on the limited Company. The Company having failed to comply, a best judgment assessment was made on an estimated income of Rs 10,000. The Company was subsequently wound up and the Official Receiver disputed the I.T.O.'s claim. Justice Srivastava held that the I.T.O.'s assessment was binding, but the Official Receiver was entitled to call upon the I.T.O. to prove to the winding up court that the debt was valid. So far as the actual assessment was concerned, Justice Srivastava held: "These accounts show that the Company did not make any profit during the year. On the contrary it suffered a loss of Rs 3,54,234-1-2. Under the circumstances the assessment is clearly unjustified and I am not prepared to treat the debt as valid or properly binding on the Company. The result is that I disallow the claim."

The Calcutta High Court in Keshardeo Chamaria's case (1935, I T R 418) made very important observations on "Best Judgment assessment." According to this decision the following are the only questions that can be raised in an appeal against a decision under section 27 arising out of an assessment under section 23(4).

These are:

Whether (1) the assessee was prevented by sufficient cause from making the return required by section 22; or whether (2) he received a notice issued under section 22(4) or 23(2); or whether (3) he had a reasonable opportunity to comply with the terms of the notices; or whether (4) he was prevented by sufficient cause from complying with the

terms of the notices and that all these being questions of fact there can be no reference under section 66(2) or (3) from an order under section 23(4) or an appellate order under section 27.

Valid Return:—

The Return must be properly filled in If the Return is not signed or if the Return contained the words "approximately," "roughly," "about" or such other expressions, the Return would be invalid

If the Return is duly signed but income from all the sources have not been given it may still be a valid Return but incomplete Return

If an assessee deliberately fails to comply with the requirements of a Return it is invalid

A Return must be verified either by the assessee himself or by his duly authorised agent or representative. A Return should be made by

(1) a partner of a firm,

(2) the principal officer of a Company,

(3) the Karta of the H U F

Section 22(4).

(1) Is a notice for a specific thing, *viz.*, Accounts or documents

(2) It can be issued at any stage [after 22(2) has been served

(3) It is optional by law though by practice it has become necessary (para. 88, I.T M.).

(4) Non compliance of this notice will mean a prosecution under section 51 or penalty under section 28.

(5) "Or" in "Accounts or documents" has the force of "and."

Section 23(2).

(1) It is of general nature, *i.e.*, any evidence on which an assessee may rely in support of his return.

(2) It pre-supposes a Return.

(3) It is obligatory by law if I.T.O. thinks the Return to be incorrect or incomplete.

Any assessment will be illegal if assessee is not allowed this opportunity in case I.T.O. has any objection to the Return

(4) In the above, the points of objection need not be specified by I T.O.

(5) Income tax Officer cannot ask for both assessee's attendance and production of evidence.

(6) It is a very definite and necessary step for correcting and substituting a Return

(7) Non compliance of this notice will not mean prosecution but assessment under section 23(4).

I.T.O. can always postpone a case if he considers necessary or at the request of the assessee to give him suitable time. I.T.O. can refuse to give time in which case it may raise a question of law under certain circumstances where the question of 'reasonable time' is involved.

Order in which Income-Tax Officer works up to the actual assessment.

Section 22(1). or **Section 22(2).** — 60 days / 30 days

- Return ..
  - Invalid; Notice under 22 (4) — **Assess under 23 (4) [appealable]**
  - Valid. If necessary, for verification notice under sections 22(4) and 23(2) — **Assess under 23 (3)**
- No return — Notice under 22(4) — Assess under 23 (4) **and penalty under Sec. 28**

Section 22(4). Production of accounts or documents (if generally considered necessary).

Section 23(2) Production of evidence or Personal attendance — if return is considered incomplete

Section 22(1). Voluntary Return.

Section 22(2). Return on Requisition.

Section 23(5)(a).—Registered firm.

Partners are to be separately taxed *instead of the firm as such*. Therefore the firm's profits will be, first, determined and they will be included in the separate incomes of the partners.

Section 23(5)(b). Unregistered firm

The *firm as such* may be assessed but the Income-tax officer has the option, if he finds it a revenue gain, to treat the unregistered firm as a registered firm for assessment purposes

In the opinion of the author, Section 23(5)(*b*) is a bad piece of legislation Its aim avowedly is revenue only, without the slightest consideration for formulating a principle in law The Legislature has framed a law and in the law, a choice is given to the business people to make a registered firm or an unregistered firm To give this choice and to allow a firm to carry on as an unregistered firm and then at the end of the year, to treat it as a registered firm with the sole purpose of annexing a larger amount of tax, is a negation of any principle of law This legislation, instead of encouraging business resourcefulness, intelligent lay out of business plans, and devices of business formations within the frame work of the law as are contemplated by the judgment of the Privy Council in C.I.R. *vs.* Fisher's Executors, 1926, A C. 395 has definitely ignored them.

Besides this objection, this will give rise to many complications and delay There are many business men who have all kinds of partnership businesses and individual concerns in several important centres of business. It will be often experienced that such cases of assessments are held up until the other places in the same province or in other provinces have finally supplied their figures. Then the question will arise as to who, amongst the Income Tax Officers of different places, will be responsible for

assessment. Such difficulties are bound to arise and enormous amount of delay is inevitable. A large amount of calculation both as registered firm and unregistered firm have to be made. All this for a petty little gain. When one looks at the gain which is obtained at the sacrifice of a principle in law, one may feel utterly disappointed.

In Bhiwani Sahai Bishambar Dayal *vs.* C.I.T., Punjab, N.W.F.P. and Delhi, 1936, I.T.R. 222, the case was as follows:—The assessment included certain local businesses in the Punjab as to which there is no contest. The dispute relates solely to the business 'Malwa Cotton Factory' (press), at Ujjain in Gwalior state outside British India, income from which was included at an estimated amount of Rs. 40,000. It was for non-production of the books of that factory that the assessment was made under section 23(4). The assessee put forward two contentions before the Commissioner, namely, that the share in that factory belonged to Bishamber Dayal individually and not to the assessee family, and that in any event the books could not be produced to show that there were no remittances of income therefrom in the period under assessment . .

" The assessee family have been pleading that the account books of the press are not in their control and that they have been unable to induce the persons in charge of the business to lend them the required books for the purposes of their assessment. For this reason, the main contention before us was that the notice under Section 22(4) of the Act to produce the account books of Ujjain was ultra vires, and that therefore the assessee had been prevented by sufficient cause within the meaning of Section 27 of the Act from complying with the terms of the notices issued by the Income Tax Officer . . . .

Held, that the income-tax authorities were entitled to require the assessee to produce the accounts of his foreign business for determining the profits made therein and to make an assessment under Section 23(4) on his refusal to produce them. . . ."

Sec. 23A. (1) Where the Income-tax Officer is satisfied that in respect of any previous year the profits and gains distributed as dividends by any company up to the end of the sixth month after its accounts for that previous year are laid before the company in general meeting increased by any income-tax payable

thereon are less than sixty per cent. of the assessable income of the company of that previous year, he shall, unless he is satisfied that having regard to losses incurred by the company in earlier years or to the smallness of the profit made, the payment of a dividend or a larger dividend than that declared would be unreasonable, make with the previous approval of the Inspecting Assistant Commissioner an order in writing that the undistributed portion of the assessable income of the company of that previous year as computed for income-tax purposes shall be deemed to have been distributed as dividends amongst the shareholders as at the date of the general meeting aforesaid, and thereupon the proportionate share thereof of each shareholder shall be included in the total income of such shareholder for the purpose of assessing his total income;

Provided that when the reserves representing accumulations of past profits which have not been the subject of an order under this sub-section exeed the paid-up capital of the company, together with any loan capital which is the property of the shareholders, or the actual cost of the fixed assets of the company whichever of these is greater, this section shall apply as if instead of the words 'sixty per cent. of the assessable income' the words 'one hundred per cent. of the assessable income' were substituted;

Provided further that no order under this sub-section shall be made where the company has distributed not less than fifty-five per cent. of the assessable income of the company, unless the company on receipt of a notice from the Income-tax Officer that he proposes to make such an order, fails to make within three months of the receipt of such notice a further distribution of its profits and gains so that the total distribution made is not less than sixty per cent. of the assessable income of the company of the previous year concerned;

Provided further that this sub-section shall not apply to any company in which the public are substantially interested or to a subsidiary company of such a company if the whole of the share capital of such subsidiary company is held by the parent company or by the nominees thereof;

Explanation.—For the purpose of this sub-section,— .

A company shall be deemed to be a company in which the public are substantially interested if shares of the company (not being shares entitled to a fixed rate of dividend, whether with or

without a further right to participate in profits) carrying not less than twenty-five per cent. of the voting power have been allotted unconditionally to, or acquired unconditionally by, and are at the end of the previous year beneficially held by, the public (not including a company to which the provisions of this sub-section apply), and if any such shares have in the course of such previous year been the subject of dealings in any stock exchange in British India or are in fact freely transferable by the holders to other members of the public.

(2) The Inspecting Assistant Commissioner shall not give his approval to any order proposed to be passed by the Income-tax Officer under this section until he has given the company concerned an opportunity of being heard.

(3) (ii) Where the proportionate share of any member of a company in the undistributed profits and gains of the company has been included in his total income under the provisions of sub-section (1) the tax payable in respect thereof shall be recoverable from the company if it cannot be recovered from such member.

(iii) Where tax is recoverable from a company under this sub-section, a notice of demand shall be served upon it in the prescribed form showing the sum so payable, and such company shall be deemed to be the assessee in respect of such sum, for the purposes of Chapter VI.

(4) Where tax has been paid in respect of any undistributed profits and gains of a company under this section, and such profits and gains are subsequently distributed in any year, the proportionate share therein of any member of the company shall be excluded in computing his total income of that year.

(5) When a company is a shareholder deemed under sub-section (1) to have received a dividend, the amount of the dividend thus deemed to have been paid to it shall be deemed to be part of its total income for the purpose also of the application of that sub-section to distributions of profits by that company.

Power to assess individual members of certain companies.

It was noticed that firms, companies or other associations of individuals carrying on any business are sometimes formed for the purpose of evading or reducing their liability to tax. This section was designed to bring within it such firms, companies, etc. In such a case, the

firms, companies, and other association of individuals would not be taxed as such, but each member of the firm or association or company would be taxed by determining the share of each member.

NOTE.—Super-tax on companies is at a flat rate but on individuals at graduated rates. It may mean much greater advantage to break up a business into several companies and thus considerably reduce liability.

According to the old Act:—

Sub-section (1) dealt with firms and associations of individuals (except Hindu undivided family) and stated that before they were brought within this section two conditions would have to be satisfied that

(a) it was under the control of one member thereof,

(b) it was formed for the purpose of evading or reducing the liability of any member to tax.

Sub-section (2) dealt with companies and stated that before a company could be brought within this section the following conditions would have to be satisfied—

(a) It was under the control of not more than 5 of its members

(b) Its profits and gains were allowed to accumulate beyond its reasonable needs.

(c) The accumulation or failure to distribute was for the purpose of evading tax on profits accumulated or not distributed.

(d) It was not a subsidiary company or one in which the public are substantially interested.

In spite of the elaborate provisions in this section, Sir David Yule's estate escaped a huge amount of tax by turning the undistributed profits of the large number of companies into Debentures.

According to the new Act of 1939:—

(1) The whole section 23-A relates to a *company* in the matter of avoidance of tax.

(2) Where the I.T.O. finds that the total gross dividend distributed is less than 60 per cent. of the assessable income, and that,

(3) he is satisfied that there is no reason or justification (either on the ground of losses of earlier years or of smallness of profits of this year) for not declaring higher dividends,

(4) he shall make an order in writing that the undistributed portion shall be deemed to have been distributed.

(5) Before this order, previous approval of the assistant Commissioner is required.

(6) This dividend shall be included in the income of such shareholder for assessing his total income.

(7) If 60 per cent. is not distributed, the I.T.O. will treat the entire 100 per cent. as distributed.

(8) If the total dividend distributed be not less than 55 per cent., the company shall be given an opporunity of making up the deficiency within 3 months.

(9) If the accumulation (reserves) of past profits exceed the larger of the two following items :—

(*a*) Total paid-up capital and loan capital (being shareholders moneys),

or (*b*) Actual cost of the fixed assets of the company, then the entire 100 per cent. must be deemed to have been distributed.

(10) The above points do not relate

(*a*) to any company in which the public are substantially interested,

or (*b*) to a subsidiary company of such a company if the whole of the share capital of such subsidiary company is held by the parent company or by the nominees thereof.

In other words a subsidiary company which is truly a part and parcel of a public company cannot be penalised by the above sub-section.

Mr. S. P. Chambers :—

" What I suggest is that we do not want the Income-tax Officer to say to the company, " You ought to have done this or you ought to have done that " That type of power was given in the old section which worked so badly We want to say now just this : If the profits that have been distributed are 60 per cent. or more, then this section does not come into operation. If they are less than 60 per cent. then, subject to the second proviso which gives a certain time limit where it is over 55 per cent. subject to that we say that we do not want to give the Income-tax Officer any discretion : he must automatically treat the company as though it were a firm and assess the shareholders as though they were partners in the firm : And I suggest that to give any discretion to an Income-tax Officer in a matter like this, is very undesirable "

In Harvey *vs* C.I.T., Madras, 1955, I.T.R 311, the I.T.O. contended that the Company's (Comorin Investment and Trading Co., Ltd.) profits were allowed to accumulate beyond its reasonable needs without being distributed among its members The High Court held that the income-tax authorities were entitled to come to the conclusion that there was an intention to prevent the imposition of tax and to assess the shareholders under section 23-A.

Sec.24. (1) Where any assessee sustains a loss of profits or gains in any year under any of the heads mentioned in section 6, he shall be entitled to have the amount of the loss set off against his income, profits or gains under any other head in that year;

Provided that where the assessee is an unregistered firm which has not been assessed under the provisions of clause (b) of sub-section (5) of section 23 in the manner applicable to a registered firm, any such loss shall be set off only against the income, profits and gains of the firm and not against the income, profits and gains of any of the partners of the firm; and where the assessee is a registered firm, any loss which cannot be set off against other income, profits and gains of the firm shall be apportioned between the partners of the firm and they alone shall be entitled to have the amount of the loss set off under this section;

(2) Where any assessee sustains a loss of profits or gains in any year, being a previous year not earlier than the previous year for the assessment for the year ending on the 31st day of March, 1940, under the head 'Profits and gains of business, profession or vocation,' and the loss cannot be wholly set off under sub-section (1), the portion not so set off shall be carried forward to the following year and set off against the profits and gains, if any, of the assessee from the same business, profession or vocation for that year; and if it cannot be wholly so set off, the amount of loss not so set off shall be carried forward to the following year, and so on; but no loss shall be so carried forward for more than six years, and a loss arising in the previous years for the assessment for the years ending on the 31st day of March, 1940, the 31st day of March, 1941, the 31st day of March, 1942, the 31st day of March, 1943, and the 31st day of March, 1944, respectively, shall be carried forward only for one, two, three, four and five years, respectively:

Provided that nothing herein contained shall entitle any assessee, being a registered firm, to have carried forward and set off any loss which has been apportioned between the partners, under the proviso to sub-section (1), or entitle any assessee, being a partner in an unregistered firm which has not been assessed under the provisions of clause (b) of sub-section (5) of section 23 in the manner applicable to a registered firm, to have carried forward and set off against his own income any loss sustained by the firm:

Provided further that where an unregistered firm is assessed as a registered firm under clause (b) of sub-section (5) of section 23, during any year, its losses shall also be carried forward and set off under this section as if it were a registered firm:

Provided further that where a change has occurred in the constitution of a firm or where any person carrying on any business, profession or vocation has been succeeded in such capacity by another person, otherwise than by inheritance, nothing in this section shall be deemed to entitle any person other than the person incurring the loss to have it set off against his income, profits or gains.

(3) When, in the course of the assessment of the total income of any assessee, it is established that a loss of profits or gains has taken place which he is entitled to have set off under the provisions

of this section, the Income-tax Officer shall notify to the assessee by order in writing the amount of the loss as computed by him for the purposes of this section.

(A) Under Section 24(1) loss under one head of income may be set off against profits under another head in the *same year*.

Illustration 68.

(*a*) A has Rs. 2,000 interest from securities and has incurred a loss from business in that year Rs. 3,000. In this case his total income will be Rs. (1,000)

Illustration 69.

(*b*) A firm has :—

(1) House Property (assessable income)	Rs. 3,500
(2) Interest from securities	Rs 4,500
(3) Loss from business ..	Rs. 7,000

In this case, total income is Rs 1,000 (8,000 - 7,000).

Mark the words "that year" in Section 24(1).
.. .. .. " same business " in Section 24(2)

(B) Under Section 24(2), an exception to the sub-section (1) is, that a loss under the head "Profits or gains of business, profession or vocation" may be set off in the following years.

(C) This set-off in sub-esction (2) is only permissible under the following conditions :—

(*a*) against the same source (not head), *i.e.*, the same business, same profession and same vocation,

(*b*) that the carry forward of business loss can be continued to the maximum period of six years,

(c) in slow stages, *i.e.*, this carry-forward is fully effective in the assessment year 1944-45 as shown below :—

In assessment year	Loss incurred in the account year	Can be carried forward	Up to assessment year
1939-40	1938-39	1 year	40-41
1940-41	1939-40	2 years	41-42 to 42-43
1941-42	1940-41	3 years	42-43 to 44-45
1942-43	1941-42	4 years	43-44 to 46-47
1943-44	1942-43	5 years	44-45 to 48-49.
1944-45	1943-44	6 years	45-46 to 50-51
1945-46	1944-45	6 years	46-47 to 51-52
1946-47	1945-46	6 years	47-48 to 52-53

That is, the first loss which can be carried forward for full six years (*i.e.*, up to 1950-51) will be the loss arising in the previous year (1943-44) for assessment in 1944-45.

(D) Registered firm.

Section 24(1) Proviso : Any loss which cannot be set off against other income, profits and gains of the firm, shall be apportioned between the partners.

Illustration 70

A registered firm has :-

House Property (assessable income)	Rs. 3,500
Income from securities ...	Rs. 4,500
Loss from business ..	Rs. 9,000

The total income is Rs. — 1,000 (8,000 — 9,000).

The proviso allows that the *minus* quantity can be utilised in reducing the personal assessments. Thus the minus quantity will be divided by the two equal partners and deducted from their personal incomes.

If one of the partners has a separate income of Rs. 7,000, his total income will be:

Rs. 7,000

Rs. 500 (his share of firm loss).

Rs. 6,500 to be taxed.

In the same way, the other partner may also set off his firm loss against profits and gains on any other head

Section 24(2) Proviso I.

Once a Registered firm's loss has been apportioned between the partners, the firm loss as such shall not be carried forward

(E) Unregistered firm:

(*a*) Where the firm has not been assessed under Section 23(5)(*b*) in the manner applicable to a registered firm:—

(*i*) Firm loss can be set off only against income of the firm (24(1) Proviso)

(*ii*) A partner shall not carry forward and set off even in the same year against his other incomes, his own share of loss sustained by the firm (24(2) proviso (1)).

(*b*) If assessed under section 23(5)(*b*) the firm loss shall be carried forward and set off as if it were a registered firm. That is, the firm loss shall be apportioned between the partners and set off against their individual assessments.

(F) If a particular business is discontinued, the carry-forward will cease

(G) Such carrying forward is not allowed if there is a change in the constitution of a firm or if a person is succeeded by another person except by way of inheritance.

Illustration 71.

P & L A/c.

To Salaries	Rs. 7,000	By Gross Profit	Rs. 12,000
,, Rent	Rs. 1,000	,, Loss	Rs. 8,000
,, Trade Exp.	Rs. 6,000		
,, Salary to A	Rs. 6,000		
	Rs. 20,000		Rs. 20,000

P & L adjustment A/c

To Loss	Rs. 8,000	By Salary A	Rs. 6,000
		,, Firm Loss	Rs. 2,000
	Rs. 8,000		Rs. 8,000

Salary of A	Rs. 6,000	
Less	Rs. 4,000	Rs. 2,000 profit
Share of loss of B		Rs. 4,000 loss

B will not be allowed to set off his loss against other incomes.

Illustration 72

P & L A/c

To Salary	Rs. 7,000	By Gross Profit	Rs. 15,000
,, Rent	Rs. 1,000	,, Loss	Rs. 6,000
,, Trade Exp.	Rs. 5,000		
,, Interest to A	Rs. 8,000		
	Rs. 21,000		Rs. 21,000

P & L Adjustment A/c.

To Loss	Rs. 6,000	By Interest to A	Rs. 8,000
,, Firm's Profit	Rs. 2,000		
	Rs. 8,000		Rs. 8,000

A's share	Interest	Rs. 8,000	
	Less	Rs. 3,000	
			Rs. 5,000 Profit
B's share			Rs. 3,000 Loss

Here B will be allowed to set off his loss against his other incomes because the Firm has been *assessed to tax*

In the absence of any prohibition, this set-off should be allowed

Set off of loss against Total Income.

Depreciation Claim.

Sec 10(2)(*b*)

Where full effect of depreciation claim cannot be given owing to insufficiency of profits, the unabsorbed depreciation shall be added to the depreciation allowance for the following year and subsequent years

Business Loss.

Sec 24(1) **Loss under any head.**

Where any assessee sustains a loss in any year under any head it can be set off against any other head in that year

Proviso In case of unregistered firm assessed as unregistered firm, any loss shall be set off against income of that very firm - not against the partners or any other head

Sec 24(2) **Loss under head "Business."**

Where any assessee sustains a loss in business profession or vocation and the loss cannot be set off under Sec 24(1) the unabsorbed portion shall be carried forward next year and set off against profits and gains from the same business, profession or vocation for that year, and if it cannot be wholly set off, the amount of loss not so set off shall be carried forward to the next year and so on but not beyond 6 years

NOTE.—Loss of profits or gains in any year occurring in section 24(1), may arise if one business shows unabsorbed depreciation and another business of the same assessee, lesser profits or loss.

This section is extremely difficult and confusing, and the following method of working is suggested :-

(1) Find out in every P and L a/c—Business-profit or business-loss, without debiting depreciation-claim, with a view to treat business-loss and depreciation-claim separately.

(2) **In case of profits as per (1) above,** the current year's depreciation-claim shall be set off against profits of each business unit, thereby Profit and Loss of each business unit is to be worked out separately;

(*a*) If there remains any unabsorbed depreciation under any unit, it can be set off against any income from other heads under section 24(1)

(*b*) If after setting off all incomes from other heads against the unabsorbed depreciation of the business units, there still remains any unabsorbed amount of depreciation, it is to be carried forward as such separately for each unit for future set off

(3) **In case of losses as per (1) above,** the current depreciation claims and current business-losses should be separately treated in respect of each unit When there are profits under other heads, in the absence of any specific mention in the Act regarding setting off either business loss or unabsorbed depreciation, the assessee, in the opinion of the author, should be given the choice of either

(*a*) setting off business-loss, first, or

(*b*) setting off unabsorbed depreciation (U/D), first, or

(*c*) proportionate abatement of both business loss and unabsorbed depreciation (U/D).

It will, however, be more advantageous to set off current year's business loss against profits under other **heads,**

first, as, this loss can only be carried forward for 6 years.

(*This preference refers to current year's claims*).

If any balance still remains, then, the depreciation claims will now be set off and if still unabsorbed depreciation remains, it would be carried forward separately for each unit.

(4) Between unabsorbed depreciation brought forward and business loss brought forward of a unit, the former, *i.e.*, unabsorbed depreciation of preceding years is to be set off first and then the business losses of preceding years, keeping in view that this business loss can be set off only against profits of that *very business* under section 24(2).

(*This preference refers to brought forward claims*)

Reasons for Preference as in (3) above

(1) In the absence of provisions in the Act as to whether in the case of business loss of the current year and depreciation allowance of the current year (including unabsorbed depreciation of previous year), the former should have the prior claim to be set off against any income from other sources or the latter, it seems more reasonable, equitable and advantageous also, to give preference to business loss, because, depreciation can be carried forward indefinitely until absorbed, whereas, the business loss brought forward can only be set off against any future profits of the *same business* after allowing depreciation, and that only for a maximum period of 6 years

(2) This interpretation gains particular force on the ground that when there is a loss on the head " property " and also on the head " business " it is obvious that the house property loss is set off first under sec 24(1) against income from any other source and subsequently the

business-loss is set off. It is reasonable that the amounts which can be set off in future years should allow other items precedence. At least, the assessee is clearly entitled to this benefit.

Illustration 73.

Illustrations		**1st year** *Solutions.*	
Dpn. Claim in rupees	Profit or Loss in rupees	D Excess* of Dpn. allowance over available profits	
2,000—D	500 P	(U/D)	1,500
1,000—S	2,000 P	S Profit	1,000
No other income		D	500 (U/D)
		2nd year	
1,300—D	1,700 P	D Profit	1,700
2,800—S	2,200 P	Less Dpn. 500	
No other income.		1,300	1,800
		D	100 (U/D)
		S	600 (U/D)

Note

All figures are in Rupees

P—means profits

L means losses

D—stands for Druggists shop

S stands forSports shop

Dpn—means depreciation

U/D - means unabsorbed depreciation

C/F—means carried forward

B/F—means brought forward

* This excess may be called loss for purpose of Sec 24 (1) but not for Sec. 24 (2).

Note :—This problem of 5 years' accounts has, however, been worked out on the basis of the third option of the assessee *viz* proportionate abatement.

(A) **3rd year**

Illustrations		*Solutions*		
1,100-D	500 L	**D** Business Loss		500
1,500-S	2,500 L	Dpn Claim	100	
			1,100	1,200 (U D)
Other incomes 1,200		**S** Business Loss		2,500
		Dpn Claim	600	
			1,500	2,100 (U D)

(a) Now set off against 1,200

(b) Preference to current year's Business Loss

Therefore [illegible] 1,200 = 200 set off

and [illegible] 1,200 = 1,000 set off

Therefore proportionate abatement gives

D Business Loss	500	
Loss	200	
		300 (C F)
Depreciation		1,200 (U D)
S Business Loss	2,500	
Loss	1,000	
		1,500 (C F)
Dpn		2,100 (U D)

(B)

1,100 D	500 P	**D** Dpn claim	100
Nil – S	Nil		1,100
			1,200
Other incomes	1,200	against profits	500
			700 (U D)

S B F 600 (U D)

Under section 24(1), U D of the two is to be proportionately set off against Rs 1,200.

(C) **Illustrations** **Solutions**

Dpn. Claim in rupees	Profit or Loss in rupees
1,100—D	500 P
1,400—S	2,600 L
Other incomes	1,200

D Profit 500

Less Dpn 100

1,100

—— 1,200

700 (U/D)

S Business Loss 2,600

Dpn claim 600

1,400

—— 2,000 (U/D)

Now set off the business loss of **S** against other incomes

4th year

Continuing (c) above:—

800—D	800 L
1,000—S	1,500 L
Other incomes	3,800

D Business Loss 800

U/D 700 + 800 1,500

S Business Loss 1,500 + 1,400 2,900

U/D 2,000 + 1,000 3,000

Now set off business losses of the year

D 800

S 1,500

As there is no profit from the business **S**, the loss of Rs. 1,400 cannot be set off this year and will be carried forward.

4th year's balances:—

D Business Loss Nil

U/D 1,500 ...

*Less 500 1,000

*Other incomes of 4th year 3,800 after being set off by business losses is Rs. 1,500 (3,800 2,300). This Rs. 1,500 proportionately divided between the two U/D figures of the 4th year gives Rs 500 and Rs. 1,000.

S Business Loss Rs. 1,400 (brought forward from 3rd year).

U D	3,000	
*Less	1,000	
		2,000

5th year

700—D	1,800 P	D-Profit		1,800
800—S	3,200 P	Less Dpn	700	
Other incomes Rs 2,000			1,000	
				1,700
				100P
		S-Profit		3,200
		Less Dpn	800	
			2,000	
				2,800
				400P

Set off old losses of Rs 1,400 under sec 24(2) Therefore, the balance Rs 1,000, the loss of 3rd year which could not be set off has therefore to be carried forward.

Final Result

(1) Drug Business-Profit	100
Other incomes	2,000
Assessable	2,100

(2) Old loss of Sports business to be carried forward until the sports business makes sufficient profits but not beyond 6 years Rs. 1,000

Illustration 74.

1939-40 Assessment year.

Business loss—Rs. 5,000—to be carried forward.

Depreciation—Rs. 10,000—to be carried forward.

1940-41 Assessment year.

Business profits Rs. 10,000 (Prior to debit of depreciation)

Depreciation for the year Rs 27,000.

House property income Rs. 15,000.

Solution.

1st working		Rs
(1) Profits		10,000
Less depreciation ...	10,000	
	27,000	
	--	37,000
Under section 10(2) (vi) proviso (b) ...		27,000
House property income under section 24(1)		15,000
Unabsorbed depreciation		12,000

(2) Business loss of the previous assessment year Rs 5,000 carried forward and as section 24(2) could not be applied, this old loss ceases to be continued beyond 1940-41 assessment.

(3) This old loss Rs. 5,000 could have been set off against profits Rs. 10,000 (assessment year 1940-41) under section 24(2). Conflict arose as to whether carry-forward of loss would have precedence over carry-forward of unabsorbed depreciation.

2nd working	Rs.
(1) Profits	10,000
Previous Business Loss	5,000
Under section 24(2)	5,000
Less Depreciation	37,000
	32,000
House Property income under section 24(1)	15,000
Unabsorbed depre.	17,000

(2) Section 24(2) is applied. Hence old loss is recouped.

(3) Carry-forward of loss is given precedence over unabsorbed depreciation This is probably not correct. This method is not acceptable.

Certainly, depreciation will have precedence as it is an essential business debit under section 10 which is a pre-requisite for determination of business profit or loss.

(4) If however business profit of Rs. 10,000 is replaced by a loss of Rs. 2,000, then what happens?

Then loss	Rs	2,000
Add Depreciation	Rs	37,000
		39,000
House Property income under section 24(1)		15,000
Unabsorbed depreciation		24,000

In South Indian Industrials, Ltd vs C I T, Madras (1935), I.T.R 11, the assessee company carried on many businesses—tile works, cement works, rice mills etc It also held shares in other companies carrying on similar business In the particular year of assessment, the company received large dividends from other companies and when the Income-tax Officer charged it to tax, the assessee claimed to set off a large amount of loss alleged to have been incurred in the various businesses so long conducted by the assessee and which stopped working about 5 years ago. No trade was done in the year of account in those businesses in respect of which the set-off was claimed The Income-tax Officer contended that the assessee was not entitled to set off, against dividends, losses in business which ceased to be carried on. The assessee contended that so long as those businesses were not officially wound up, they would be supposed to be carried on. The High Court decided that the assessee company was not entitled to set off the losses claimed.

In Arunachalam Chettiar, vs. C I.T., Madras, 1924 1, I.T.C. 278, the assessee carried on one business individually and the other as a member of an unregistered firm. It was decided that he was entitled to set off the loss incurred by him in respect of partnership against profits made by him in his individual business. Schwabe C. J., said:—I can find nothing to justify the argument that each partner in a firm is not an assessee for he is a person by whom the income-tax is payable. . . .the words "any business"

being open to either construction, I must take that construction which, looking at the whole Act, is the more rational, and must construe 'any' to mean "each and every". It follows that an assessee is entitled to set off profits in one business against losses in another. . . .no distinction can be made between registered and unregistered firms for whether a firm is a legal entity or not does not depend on registration.

The above decision was upheld by the Judicial Committee of the Privy Council (Rm. Ar. Ar. Rm. Arunachallam Chettiar, *vs.* C.I.T., Madras, 1936, I.T.R. 173 (P.C.). After the Amendment Act of 1939, this decision becomes inoperative.

In the above case of *Arunachalam Chettiar* it was also decided that an assessee was not entitled to set off against his income, loss or bad debts arising to his business partner due to whose insufficient means, the business loss had to be written off in the accounts. The assessee was not allowed to charge against his second business profits, his ex-partner's share of loss which had to be borne by him.

In Bansilal Abirchand, Nagpur, 1928, 3 I.T.C. 57, the assessee was carrying on several businesses of stock jobbing and dealing in various commodities The assessee adopted his own method of account keeping viz., not striking profit or loss of the accounts each year but closing each line of business when the business ceased. In 1925-26, the assessee claimed a set off of 6 lakhs of rupees. The Income-tax Officer accepted his account-keeping method when it showed a profit but now insisted on closing his accounts every year and rejected the claim of set off as being losses of previous years. It was held that "unless and until, the commissioner sees cause to insist under section 13 of the I.T. Act on the assessee employing another method of accounting, the assessee was entitled to claim a debit for the loss" on the basis of his special method of account keeping.

Important Incometax-accounts matters in Sections 24A to 68

Super-tax.

1. In addition to Income-tax, Super-tax shall be charged on the total income of—

(a) Individual.

(b) Hindu undivided family.

(c) Company.

(d) Local authority.

(e) Unregistered firm.

(f) Other associations of persons (not being registered firm)

(g) Partners of the firm or members of the association individually.

2. Super-tax is levied on slab basis, i.e., different slabs of the income are super-taxed at different (progressive) rates

3. Super-tax on Companies is levied at a flat rate of one anna per rupee.

4. Where an unregistered firm or other association of persons not being a company have been assessed to S. T., a partner or a member of the association shall not pay S. T. in respect of his share.

5. Where an unregistered firm has been assessed as a registered firm, S. T. shall be payable by each partner individually

6. By the Amendment Act, the word "individual" has been replaced by "a partner of the firm or a member of the association."

7. Super-tax is in addition to Income-tax.

8. The total income for Income-tax is the total income for Super-tax.

9. All provisions relating to Income-tax will apply to Super-tax except as provided under Section 58

10. Free of tax securities are not free from Super-tax (only free from Income-tax).

11. Super-tax to be deducted at source.

12. Hence, the question of refund will arise.

13. Super-tax is charged to individuals at graduated rate on incomes exceeding Rs. 25,000 (Joint-Stock Company dividends will be included in the total income and will be taxed again).

14. Super-tax is charged to association of persons.

15. Super-tax is charged to unregistered firm.

16. Deductions of Life Insurance premiums and Provident Fund payments are not allowed for Super-tax purposes.

17. Super-tax is not charged to registered firm as such but through partners in their individual assessments.

18. Deduction of Super-tax to be made on salary

19. Deduction of S. T. not to be made on Interest on securities.

20. Deduction of S. T to be made on Dividends payable to non-residents.

Illustration 75.

An individual has computed his total income to be Rs. 1,05,500 comprising of

Business income	Rs.	85,500
Investment income (gross)	Rs	20,000
	Rs	1,05,500

His Super-tax will be calculated as follows

Rs. 25,000	nil		
Rs 10,000 at -/1/-	625		
Rs 20,000 at /2/-	2,500		
Rs 50,500 at -/3/-	9,468	12	0
Rs	12,593	12	0

Illustration 76.

A limited company having Rs 1,05,500 as its total income will have to pay Rs. 6,593 12 0 at the rate of 1 anna on Rs 1,05,500 (according to 1942 Finance Act, 1½ annas on Rs. 1,05,500)

Illustration 77.

Recognised Provident Fund (see page 160).

A's salary is Rs. 400 per month in a mercantile house where he pays Rs. 25 per month from his pay to the Recognised Provident Fund A's employer pays Rs 600 annually to A's credit by way of P. F. contribution. A pays life insurance premium of Rs. 1,200 annually. Find out A's taxable income.

Statement of Taxable Income.

1. Net salary	Rs. 4,500		
Employer's P. F. contribution...	Rs. 300		
		Rs. 4,800	

2. **Annual accretion :—**

Employer's contribution	Rs. 600		
Employee's „ ...	Rs. 300		
Int. on P.F. A/c ...	Rs. 108		
		Rs. 1,008	
Less Employee's contribution		Rs. 300	
			Rs. 708
		Total Income	Rs. 5,508

3. Deduction on account of P.F. and L. I. P. will be ⅙ of (Rs. 5,508 *minus* Rs 708).

(*a*) Provident fund allowed ⅙ of salary	Rs. 800	
(*b*) L. I. P. due (in this case)	*nil*	
4. Exempted interest at 6% on accumulations (*i.e.*, P.F A/c)	Rs. 108	
		Rs. 908
	Taxable income	Rs. 4,600

Co-operative Society

1. Co-operative Society is to be assessed when the total Income is Rs 2,000 or over.

2. For purposes of Income-tax, mutual business profits of a Co-operative Society are exempt from I T (not from S T.) but will enter into the total income for determining the rate.

3 Therefore, Co-operative Society's profits from:—

(*a*) interest on securities

(*b*) dividends

(*c*) property

(*d*) other sources

are taxable because they are not mutual profits.

Illustration 78.

A Co-operative Society has the following incomes:—

1.	Mutual business profit	Rs. 20,000
2.	Interest on Securities (gross)	Rs. 9,000
3.	Dividends (gross)	Rs. 16,000
	Total Income	Rs. 45,000

Hence, average rate 25·03 pies in a rupee.

Tax on Rs. 45,000 is		Rs. 5,867 3 0
Less tax on Rs. 20,000 @ 25 pies=Rs. 2,607 4 0		
„ „ „ Rs. 25,000 @ 30 pies=Rs. 3,906 4 0		
		Rs. 6,513 8 0
	Refundable	Rs. 646 5 0

Illustration 79.

A man receives a salary of Rs. 300 per month. He has an investment in securities the profits from which amount to Rs. 4,000 (gross). He got a dividend from a Co-operative Society, the gross amount of dividend being Rs. 5,000.

Total Income—Salary	Rs.	3,600
Interest	Rs.	4,000
Dividend	Rs.	5,000
	Rs.	12,600

Average rate is 13-4 pies.

Tax on	Rs	12,600						Rs. 879 11 0
Less tax on	Rs.	5,000	@ 13-4	Rs	348	15	0	
„ „ „	Rs.	3,600	@ 5-2	Rs	98	7	0	
„ „ „	Rs.	4,000	@ 30	Rs.	625	0	0	
								Rs 1,072 6 0
								Rs 192 11 0

The Indian Finance Act, 1939

Rates of Income-tax

A. In the case of every individual, Hindu undivided family, unregistered firm and other association of persons not being a case to which paragraph B of this Part applies—

		Rate
1.	On the first Rs 1,500 of total income	Nil
2.	On the next Rs. 3,500 „	9 pies in the rupee
3.	„ „ 5,000 „ ...	/1/3 pies „ „
4.	„ „ 5,000 „ .	/2/ as in the rupee
5.	On the balance of total income	/2/6 pies in the rupee

Provided that—

(1) no income-tax shall be payable on a total income which does not exceed Rs. 2,000,

(2) the income-tax payable shall in no case exceed half the amount by which the total income exceeds Rs. 2,000.

B. In the case of every company and local authority, and in every case in which, under the provisions of the Indian Income-tax Act, 1922, Income-tax is to be charged at the maximum rate—

	Rate
On the whole of total income	/2/6 pies in the rupee.

Part II

Rates of Super-tax

A. In the case of every individual, Hindu undivided family, unregistered firm and other association of persons, not being a case to which paragraph B of this Part applies—

			Rate
1.	On the first Rs. 25,000 of total income	...	Nil
2.	On the next Rs. 10,000 "	...	/1/ anna in the rupee
3.	" " 20,000 "	...	/2/ as. in the rupee
4.	" " 70,000 "	...	/3/ "
5	" " 75,000 "	..	/4/ "
6.	" " 1,50,000 "	.	/5/ "
7	" " 1,50,000 "	...	/6/ "
8.	On the balance of total income	.	/7/ "

B In the case of every company and local authority—

On the whole of total income . ... /1/ anna in the rupee.

The Indian Finance Act, 1940

7 (1) Subject to the provisions of Sub-section (2)—

(a) Income-tax for the year beginning on the 1st day of April, 1940, shall be charged at the rates specified in Part I of Schedule II to the Indian Finance Act, 1939.

(b) Rates of Super-tax for the year beginning on the 1st day of April, 1940, shall for the purposes of Section 55 of the Indian Income-tax Act, 1922, be the rates specified in Part II of Schedule II to the Indian Finance Act, 1939

Provided that in the case of an association of persons being a Co-operative Society, other than the Sanikatta Saltowners' Society in the Bombay Presidency, for the time being registered under the Co-operative Societies Act, 1912, or under an Act of the Provincial Legislature governing the registration of Co-operative Societies, the rates of Super-tax for the year beginning on the 1st day of April, 1940, shall be :—

1.	On the first Rs. 25,000 of total income		Nil
2.	On the balance of total income	...	one anna in the rupee

(2) In cases to which Section 17 of the Indian Income-tax Act, 1922, applies, the tax chargeable shall be determined in accordance with the

provisions of that section with reference to the rates imposed by Sub-Section (1).

(3) For the purpose of this section and of the rates of tax imposed by Sub-section (1), the expression "total income" means total income as determined for the purposes of Income-tax or Super-tax, as the case may be, in accordance with the provisions of the Indian Income-tax Act, 1922.

The Indian Finance Act, 1941

7 (1) Subject to the provisions of Sub-sections (2) and (3)

(a) Income-Tax for the year beginning on the 1st day of April, 1941, shall be charged at the rates specified in Part I of Schedule II to the Indian Finance Act, 1939, increased in each case by a surcharge for the purposes of the Central Government amounting to one-third of each such rate.

(b) Rates of Super-tax for the year beginning on the 1st day of April, 1941, shall, for the purposes of Section 55 of the Indian Income-tax Act, 1922, be the rates specified in Part II of Schedule II to the Indian Finance Act, 1939 increased—

(i) in the case of the rate applicable to a company, by a surcharge amounting to one third of that rate, and

(ii) in the case of every other rate, by a surcharge for the purposes of the Central Government amounting to one-third of each such rate

Provided that in the case of an association of persons being a Co-operative Society, other than the Sanikatta Saltowners' Society in the Bombay Presidency, for the time being registered under the Co-operative Societies Act, 1912, or under an Act of the Provincial Legislature governing the registration of Co-operative Societies, the rates of Super-tax for the year beginning on the 1st day of April, 1941, shall be the rates of Super-tax specified in the proviso to Clause (b) of Sub-Section (1) of Section 7 of the Indian Finance Act, 1940, increased in each case by a surcharge for the purposes of the Central Government amounting to one-third of each such rate.

(2) In making any assessment for the year ending on the 31st day of March, 1942—

(a) Where the total income of an assessee, not being a company, includes any income chargeable under the head "Salaries" or under the head "Interest on Securities" or any income from dividends in respect of which he is deemed under Section 49B of the Indian Income-tax Act, 1922, to have paid Income-tax imposed in British India, the income-tax payable by the assessee on that part of his total income which consists of such inclusions shall be an amount bearing to the total amount of

Income-tax payable according to the rates applicable under the operation of the Indian Finance Act, 1940, read with Sub-section (1) of Section 3 of the Indian Finance (No. 2) Act, 1940, on his total income the same proportion as the amount of such inclusions bears to his total income ;

(b) Where the total income of an assessee, not being a company, includes any income chargeable under the head "Salaries" on which Super-tax has been or might have been deducted under the provisions of Sub-section (2) of Section 18 of the Indian Income-tax Act, 1922, the Super tax payable by the assessee on that portion of his total income which consists of such inclusions shall be an amount bearing to the total amount of Super-tax payable according to the rates applicable under the operation of the Indian Finance Act, 1940, read with Sub-section (1) of Section 3 of the Indian Finance (No. 2) Act, 1940, on his total income the same proportion as the amount of such inclusions bears to his total income

(3) In cases to which Section 17 of the Indian Income-tax Act, 1922, applies, the tax chargeable shall be determined as provided in that section but with reference to the rates imposed by Sub-section (1) of this section, and in accordance with the provisions of Sub-section (2) of this section where applicable

(4) For the purposes of this section and of the rates of tax imposed thereby, the expression "total income" means total income as determined for the purposes of Income-tax or Super-tax, as the case may be, in accordance with the provisions of the Indian Income-tax Act, 1922

The Indian Finance Act, 1942

8. (1) Subject to the provisions of Sub-sections 2 and 3—

(a) Income-tax for the year beginning on the 1st day of April, 1942, shall be charged at the rates specified in Part I of Schedule II increased in the cases to which Sub-paragraph B of Paragraph A and Paragraph B of that Part apply by a surcharge for the purposes of the Central Government at the rate specified therein in respect of each such rate of Income-tax ; and

(b) rates of Super-tax for the year beginning on the 1st day of April, 1942, shall, for the purposes of Section 55 of the Indian Income-tax Act, 1922, be those specified in Part II of Schedule II increased in the cases to which Paragraphs A, B and C of that Part apply by a surcharge for the purposes of the Central Government at the rate specified therein in respect of each such rate of Super-tax.

(2) In making any assessment for the year ending on the 31st day of March, 1943—

(a) Where the total income of an assessee, not being a company, includes any income chargeable under the head "Salaries" or under the head "Interest on Securities" or any income from dividends in respect of which he is deemed under Section 49B of the Indian Income-tax Act, 1922, to have paid Income-tax imposed in British India, the Income-tax payable by the assessee on that part of his total income which consists of such inclusions shall be an amount bearing to the total amount of Income-tax payable according to the rates applicable under the operation of the Indian Finance Act, 1941, on his total income the same proportion as the amount of such inclusions bears to his total income

(b) Where the total income of an assessee, not being a company, includes any income chargeable under the head "Salaries" on which Super-tax has been or might have been deducted under the provisions of Sub-section 2 of Section 18 of the Indian Income-tax Act, 1922, the Super-tax payable by the assessee on that portion of his total income which consists of such inclusions shall be an amount bearing to the total amount of Super-tax payable according to the rates applicable under the operation of the Indian Finance Act, 1941, on his total income the same proportion as the amount of such inclusions bears to his total income

(3) In cases to which Section 17 of the Indian Income-tax Act, 1922, applies, the tax chargeable shall be determined as provided in that section but with reference to the rates imposed by Sub-section 1 of this section, and in accordance with the provisions of Sub-section 2 of this section where applicable.

(4) For the purposes of this section and of the rates of tax imposed thereby, the expression "total income" means total income as determined for the purposes of Income-tax or Super-tax, as the case may be, in accordance with the provisions of the Indian Income-tax Act, 1942.

(5) Notwithstanding anything contained in Sub-section 1 or Sub-section 2, no tax shall be payable in cases to which Sub-paragraph (a) of Paragraph A of Part I of Schedule II applies where the assessee deposits with the Central Government in such manner and in accordance with such conditions as the Central Government may by rule prescribe for the purposes of this sub-section an amount representing not less than one rupee for every complete unit of twenty-five rupees by which his total income exceeds seven hundred and fifty rupees :

Provided that where the total income includes any income chargeable under the head "Salaries" or under the head "Interest on Securities" or any income from dividends in respect of which he is deemed under Section 49B of the Indian Income-tax Act, 1922, to have paid Income-tax imposed in British India, the amount to be deposited by the assessee in order to obtain the exemption conferred by this sub-section shall be an amount bearing to the minimum required to be deposited under the foregoing provision of this sub-section the same proportion as the amount of his total income diminished by the amount of such inclusions bears to the amount of his total income.

(6) A deposit made in accordance with the provisions of Sub-section 5 shall not in any way be capable of being charged and shall not be liable to attachment under any decree or order of any Civil, Revenue or Criminal Court in respect of any debt or liability incurred by the depositor and neither the Official Assignee nor any Receiver appointed under the Provincial Insolvency Act, 1920, shall be entitled to or have any claim on any such deposit.

(7) Where the total income of an assessee referred to in Sub-paragraph (b) of Paragraph A of Part I of Schedule II does not exceed six thousand rupees an amount representing one rupee for every complete unit of two hundred rupees of his total income as reduced by the deductions, if any, allowed under the second proviso to Sub-section (1) of Section 7, Section 15 and Sub-section (1) of Section 58F of the Indian Income-tax Act, 1922, shall be funded for the assessee's benefit and shall be paid to him on such date, not more than twelve months after the termination of the present hostilities as the Central Government may fix.

Provided that nothing in this sub-section shall apply to any part of total income to which clause (a) of Sub-section (2) applies.

Explanation

In computing the amount to be funded under this sub-section if there is an incomplete unit amounting to one hundred rupees or more it shall be reckoned as a complete unit of two hundred rupees.

Indian Finance Act, 1942

Schedule II

Part I

Rates of Income-tax

A.—In the case of every individual, Hindu undivided family, unregistered firm and other association of persons, not being a case to which Paragraph B of this Part applies—

(a) Where the total income does not exceed Rs. 2,000

		Rate
1.	On the first Rs 750 of total income	nil
2.	On the next Rs 1,250 of total income ...	six pies

Provided that no tax shall be payable on a total income which does not exceed Rs 1,500.

(b) Where the total income exceeds Rs 2,000—

		Rate			Surcharge		
		Rs	a	p	Rs	a	p.
1.	On the first Rs 1,500 of total income	0	0	0	0	0	0
2.	On the next Rs 3,500 of total income	0	0	9	0	0	6
3.	On the next Rs 5,000 of total income	0	1	3	0	0	9
4.	On the next Rs 5,000 of total income	0	2	0	0	1	2
5.	On the balance of total income	0	2	6	0	1	3

B.—In the case of every company and local authority, and in every case in which under the provisions of the Indian Income-tax Act, 1922, income-tax is to be charged at the maximum rate—

	Rate			Surcharge		
	Rs	a	p	Rs	a	p.
On the whole of total income	0	2	6	0	1	3

Part II

Rates of Super-tax

A.—In the case of every individual, Hindu undivided family, unregistered firm and other association of persons not being a case to which Paragraphs B and C of this Part apply

		Rate			Surcharge		
		Rs	a	p.	Rs.	a	p.
1.	On the first Rs 25,000 of total income	0	0	0	0	0	0
2.	On the next Rs 10,000 of total income ..	0	1	0	0	0	6
3.	On the next Rs. 20,000 of total income .	0	2	0	0	1	0

		Rate			Surcharge	
	Rs.	a.	p.	Rs.	a.	p.
4. On the next Rs. 70,000 of total income . .	0	3	0	0	1	6
5. On the next Rs. 75,000 of total income .	0	4	0	0	2	0
6. On the next Rs. 1,50,000 of total income .	0	5	0	0	2	6
7. On the next Rs. 1,50,000 of total income	0	6	0	0	3	0
8. On the balance of total income	0	7	0	0	3	6

B. In the case of every local authority

		Rate			Surcharge	
	Rs.	a.	p.	Rs.	a.	p.
On the whole of total income .	0	1	6	0	0	6

C.—In the case of an association of persons being a Co-operative Society, other than the Sanikatta Salt-owners' Society in the Bombay Presidency, for the time being registered under the Co-operative Societies Act, 1912, or under an Act of the Provincial Legislature governing the registration of Co-operative Societies.

		Rate			Surcharge	
	Rs.	a.	p.	Rs.	a.	p.
1. On the first Rs. 25,000 of total income	0	0	0	0	0	0
2. On the balance of total income	0	1	0	0	0	6

D.—In the case of every company.

On the whole of total income	0	1	6

Illustration

An individual has an income of Rs. 1,950.

			Rs.	a.	p.
Then	Rs. 750		0	0	0
	Rs. 1,200	at 6 pies =	37	8	0
			37	8	0

An individual has an income of Rs. 2,100.

			Rs.	a.	p.
Then	Rs. 1,500		0	0	0
	Rs. 600	at 9 pies	28	2	0
plus surcharge at 6 pies on Rs. 600 =			18	12	0
			Rs. 46	14	0

(According to the Finance Act, 1942)

References for Pages 1, 2 and 3

For item 1, see page	104
2, „ „	102
3, „ „	50
4, „ „	102
5, „ „	102
6, „ „	266
8, „ „	125
9, „ „	103
10, „ „	104, 105
11, 12, 13 „	142
14 „ „	139

Reference page 173

Suppose, y is the income from other sources and x is the net annual value of dwelling house.

Then, total income is $y + x$. According to the proviso:

$$\frac{1}{10}(x+y) = \frac{6}{5}x$$

$$\text{or } \frac{x+y}{10} = \frac{6x}{5}$$

$$\text{or } 5x + 5y = 60x$$

$$\text{or } 55x = 5y$$

$$\text{or } x = \frac{5y}{55} = \frac{1}{11}y.$$

(showing that the net annual value can be found out on dividing the income from other sources by 11)

Corrigenda

Page 125, Read 8 in place of item 6

„ 142, „ 11, 12, 13, in place of items 9, 10, 11.

„ 139, „ 14, „ „ „ item 12.

Index of Illustrations